UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	MDL 1446
This Document Relates To:	§	Civil Action No. H-01-3624 **(Consolidated)**
MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
ENRON CORP., et al.,	§	
Defendants.	§	
WASHINGTON STATE INVESTMENT BOARD and EMPLOYER-TEAMSTERS LOCAL NOS. 175 and 505 PENSION TRUST FUND, On Behalf of Themselves and All Others Similarly Situated,	§	Civil Action No. H-02-3401 CLASS ACTION FIRST AMENDED COMPLAINT FOR VIOLATION OF THE SECURITIES LAWS
Plaintiffs,	§	
vs.	§	
KENNETH L. LAY, JEFFREY K. SKILLING, ANDREW S. FASTOW, RICHARD A. CAUSEY, MARK A. FREVERT, STANLEY C. HORTON, KENNETH D. RICE, RICHARD B. BUY, LOU L. PAI, JOSEPH M. HIRKO,	§	

[Caption continued on following page.]

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KEN L. HARRISON, STEVEN J. KEAN, § JEFFREY MCMAHON, CINDY K. OLSON, § JOSEPH W. SUTTON, MARK E. KOENIG, § KEVIN P. HANNON, LAWRENCE GREG § WHALLEY, ROBERT A. BELFER, NORMAN § P. BLAKE, JR., RONNIE C. CHAN, JOHN H. § DUNCAN, WENDY L. GRAMM, ROBERT K. § JAEDICKE, CHARLES A. LEMAISTRE, JOE § H. FOY, JEROME J. MEYER, JOHN A. § URQUHART, JOHN WAKEHAM, CHARLS E. § WALKER, HERBERT S. WINOKUR, JR., § DAVID B. DUNCAN, DEBRA A. CASH, § DAVID STEPHEN GODDARD, JR., GARY B. § GOOLSBY, MICHAEL M. LOWTHER, § ARTHUR ANDERSEN LLP, ANDERSEN § WORLDWIDE, S.C., ANDERSEN CO. (INDIA), § ARTHUR ANDERSEN-BRAZIL, ARTHUR § ANDERSEN (UNITED KINGDOM), VINSON & § ELKINS, L.L.P., J.P. MORGAN CHASE & CO., § JP MORGAN CHASE BANK, JP MORGAN § SECURITIES INC., CITIGROUP, INC., § CITIBANK, N.A., SALOMON SMITH § BARNEY, INC., BARCLAYS PLC, BARCLAYS § BANK PLC, DEUTSCHE BANK AG, § DEUTSCHE BANK TRUST COMPANY § AMERICAS, LEHMAN BROTHERS § HOLDING, INC., and LEHMAN BROTHERS § INC. §

§

Defendants. §

§ DEMAND FOR JURY TRIAL

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OVERVIEW

1. This is a securities class action on behalf of purchasers of Enron Corporation's ("Enron" or the "Company") publicly traded equity and debt securities between 9/9/97 and 10/18/98 (the "Class Period") against:

(a) Enron's top executives and directors (the "Enron Defendants"):

Robert A. Belfer	Mark E. Koenig
Norman P. Blake, Jr.	Kenneth L. Lay
Richard B. Buy	Charles A. LeMaistre
Richard A. Causey	Jeffrey McMahon
Ronnie C. Chan	Jerome J. Meyer
John H. Duncan	Cindy K. Olson
Andrew S. Fastow	Lou L. Pai
Joe H. Foy	Kenneth D. Rice
Mark A. Frevert	Jeffrey K. Skilling
Wendy L. Gramm	Joseph W. Sutton
Kevin P. Hannon	John A. Urquhart
Ken L. Harrison	John Wakeham
Joseph M. Hirko	Charls E. Walker
Stanley C. Horton	Lawrence Greg Whalley
Robert K. Jaedicke	Herbert S. Winokur, Jr.
Steven J. Kean	

(b) Enron's accountants and partners and officers therein (collectively, "Andersen"):

Arthur Andersen LLP	David B. Duncan
Andersen Worldwide, S.C.	Debra A. Cash
Andersen-India	David Stephen Goddard, Jr.
Andersen-Brazil	Gary B. Goolsby
Andersen-United Kingdom	Michael M. Lowther

(c) Law firm that represented Enron and its related entities:

Vinson & Elkins

(d) Enron's banks:

JP Morgan	Deutsche Bank
CitiGroup	Lehman Brothers
Barclays	

2. Each of the defendants sued for fraud engaged or participated in the implementation of manipulative devices to inflate Enron's reported profits and financial condition, made or participated in the making of false and misleading statements ***and*** participated in a scheme to defraud

or a course of business that operated as a fraud or a deceit on purchasers of Enron's publicly traded securities between 9/9/97 and 10/18/98.[1] Enron extolled the current success and future prospects and earning power of its Wholesale Energy trading business ("WEOS"), and its retail Energy Services business ("EES"). During the Class Period, Enron reported very strong profits and profit growth and a strong balance sheet which enabled it to maintain an investment grade credit rating. As a result of defendants' wrongful conduct and scheme, Enron's common stock was artificially inflated to as high as $29.21, while Enron's preferred and debt securities also traded at artificially inflated prices. Defendants' scheme and fraudulent course of business was also designed to and did enable Enron to issue hundreds of millions of dollars of new equity and debt securities to investors during the Class Period.

3. This fraudulent scheme and course of business enabled defendants to pocket ***millions of dollars*** of legal, accounting, auditing and consulting fees, underwriting commissions, interest and credit facility payments, cash bonuses based on Enron's reported earnings and its stock performance and illegal insider trading proceeds, such that each defendant was significantly enriched. Enron has subsequently reported $1 billion (after-tax) in write-offs and a billion dollar shareholder equity writedown. It has restated its previously reported financial results to eliminate hundreds of millions of dollars of previously reported profits and billions more in shareholder equity. Enron's stock collapsed, its credit rating was downgraded to "junk" and it went bankrupt, as investors realized that the huge profits Enron had reported over the past several years had been grossly inflated and falsified, that Enron had hidden billions of dollars of debt that should have been reported on Enron's balance sheet and that Enron had misrepresented the current success and future prospects of its WEOS, EES and Enron's communications businesses.

4. This fraud was accomplished, in part, through clandestinely controlled partnerships and so-called special purpose entities ("SPEs") that the defendants created, structured, financed and used to do transactions with Enron to inflate its profits and hide its debt and thus perpetuate the fraud

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[1] Certain defendants named herein, including Belfer, Blake, Chan, John Duncan, Foy, Gramm, Harrison, Jaedicke, LeMaistre, Meyer, Urquhart, Wakeham, Walker and Winokur are not sued for fraud, but rather, only under non-fraud provisions of the 1933 and 1934 Acts. No allegations of fraud are made against or directed at these defendants.

by violating Generally Accepted Accounting Principles ("GAAP") and the principles of "fair presentation" of financial results. Virtually all of Enron's top insiders have been kicked out of the Company. The Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") are conducting wide-ranging investigations of the Enron fiasco. Enron and Andersen have admitted destroying incriminating evidence and Andersen has been convicted of obstruction of justice. Enron executives and Andersen officials have ***"taken the 5th"*** and refused to testify because to do so would incriminate them. While the defendants all personally profited from this scheme, public investors – from Enron employees who purchased Enron stock for their 401(k) retirement accounts and lost their life savings, to public and Taft-Hartley pension plans which invested in Enron securities and lost hundreds of millions of dollars – collectively suffered billions of dollars of damages.

SUMMARY OF COMPLAINT

5. Enron was formed in 85 when Kenneth Lay ("Lay") arranged the merger of two pipeline companies and Lay became the Chairman/CEO of the surviving entity. Over the next five years, Enron operated as a stodgy regulated natural gas company, which was burdened by excessive debt and was in danger of being taken over. Between 85-90, Enron's stock performed poorly, trading at between $5-$7 per share and Enron's top executives received very modest annual bonuses and engaged in little if any sales of Enron stock.[2]

6. In 90, Lay decided to attempt to transform Enron into a higher growth, higher profit enterprise and recruited Jeffrey Skilling ("Skilling") and Andrew Fastow ("Fastow") to become executives and help him transform Enron into a growth company which engaged in providing and trading wholesale energy resources and services, operating power plants and water supply facilities (WEOS), providing retail energy and management services to companies all over the world (EES) and later building a large broadband fiber optic communication network and also trading in broadband communication access, *i.e.*, "broadband intermediation" (Enron Communications).

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[2] All share and per share amounts are adjusted to reflect Enron's 2-for-1 stock split in 8/99.

During 90-96, Enron began to show accelerating growth in revenue and profits and its stock price rose to $23-3/4 in late 96.

7. During 93 and continuing to 01, Enron was concealing billions of dollars of debt through vehicles created by JP Morgan and CitiGroup specifically designed to finance Enron while mischaracterizing Enron's debt as other types of transactions.

8. In late 97, Enron learned that an entity it had established with an outside investor a few years earlier, Joint Energy Development Incorporated ("JEDI") – and had done transactions with to generate large amounts of the profits Enron had been able to report during 97 – had to be restructured, as the outside investor was going to withdraw from JEDI. This situation created a crisis for Enron's top insiders. Because of the involvement of the outside investor in JEDI, JEDI had been treated as independent of Enron and had ***not*** been consolidated into Enron's financial statements and results. Thus, Enron had been able to engage in transactions with JEDI as an independent third party, recognize revenue and profits from those transactions and not carry JEDI's debt on Enron's books. However, in late 97, unless JEDI could be quickly restructured by having a new, independent investor come forward, ***Enron would have to wipe out all of the profitable transactions it had done with JEDI in 97 – 40% of that year's profits – put JEDI's debt on Enron's balance sheet – some $700 million in debt – and lose the ability to generate profits from similar such deals with JEDI or its successor going forward.***

9. However, Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI. So Lay, Skilling and Fastow, with Barclays, Andersen (Enron's accountants) and Vinson & Elkins (Enron's lawyers) quickly formed a new entity called Chewco, which Enron and an Enron executive (Michael J. Kopper ("Kopper")) controlled, to buy the outside investor's interest in JEDI. Chewco ***did not have an outside equity investor willing to commit a 3% stake – the minimum required to enable Chewco and JEDI to be treated as an independent third party. Barclays loaned some $240 million to Chewco, requiring a guarantee from Enron, so that Chewco would invest in JEDI, making it possible for transactions between JEDI and Enron to artificially boost Enron's reported results. Barclays also loaned the money to two straw parties (Little River and Big River) to provide the $11.4 million in funds for the 3% "equity" investment in Chewco. But***

because Barclays knew that the purported equity investors in Chewco were, in fact, "strawmen" for Enron, Barclays required Chewco to support the purported "equity loans" Barclays made to the two "strawmen" via a $6.6 million reserve paid to Barclays! Because there was no legitimate independent outside investor in Chewco, Chewco was required to have been consolidated with Enron and ***all of Enron's 97 profits generated by transactions with JEDI would have been eliminated***!

10. By forming Chewco at year-end 97, Enron's top insiders avoided a disaster by keeping Enron's previously recorded profits from transactions with JEDI in place, thus inflating Enron's 97 reported profits by $45 million. They also kept as much as $700 million worth of debt off Enron's books, making Enron look much more creditworthy and liquid than it actually was. Chewco was now also positioned to serve as a controlled entity which Enron could use going forward to do non-arm's-length transactions with, creating phony profits for Enron (at least $350 million) and allowing Enron to conceal the true state of its indebtedness by improperly moving debt off its balance sheet and onto the books of Chewco. Between 97 and 01, Enron, its accountants, lawyers and bankers would create numerous other secretly controlled partnerships and entities and use them to generate billions of dollars of additional phony profits for Enron and to conceal billions of dollars of Enron debt by moving it off Enron's balance sheet.

11. This apparent success also enabled Enron to credibly forecast strong revenue and profit growth for the next several years. In combination, these favorable factors gave Enron ready access to the capital markets by which defendants, working together, raised billions of dollars of short-term financing for Enron via the commercial paper market and billions of new long-term capital to fund Enron's rapidly expanding businesses by selling newly issued Enron securities to public investors.

12. However, the apparent success of Enron was a grand illusion – a false picture created by manipulative devices and contrivances – a scheme to defraud and a wrongful course of business by defendants that operated as a fraud and deceit on the purchasers of Enron's publicly traded securities. Defendants' scheme was accomplished by Enron, Enron's insiders, Enron's accounting firm, Andersen, Enron's general counsel, Vinson & Elkins, and several banks, including J.P. Morgan Chase & Co. ("JP Morgan"), CitiGroup, Inc. ("CitiGroup"), Credit Suisse First Boston ("CS First

Boston"), Merrill Lynch & Co. ("Merrill Lynch"), Canadian Imperial Bank of Commerce ("CIBC"), Deutsche Bank AG ("Deutsche Bank"), Bank of America Corp. ("Bank America"), Barclays PLC ("Barclays") and Lehman Brothers Holding, Inc. ("Lehman Brothers"), who collectively pocketed hundreds of millions of dollars a year from Enron – which by 97-98 had become the ***golden goose of Wall Street – while Enron's insiders pocketed over $2 billion from sales of their Enron stock and bonuses due to Enron's reported record earnings and its strong stock performance***.

13. Enron's investment grade credit rating was indispensable to enabling it to get counterparties to do huge trading transactions with it – transactions others would not do unless assured of Enron's creditworthiness. Since Enron's trading of energy resources was the core of its WEOS business, any downgrade of its credit rating would have disastrous consequences for its core business operation. This investment grade credit rating gave Enron access to the commercial paper market – a market reserved for America's largest and most creditworthy corporations – so that it could borrow billions of dollars to maintain its liquidity and finance its capital-intensive business. Enron's access to the commercial paper market also meant that Enron's $3 billion commercial paper back-up credit line, arranged by the lead banks (JP Morgan and CitiGroup) with participating banks, would not be drawn down upon, thus limiting those banks' financial exposure to Enron. It also meant that Enron and its banks could easily sell debt securities to public investors to raise long-term capital, using the proceeds to reduce its short-term commercial paper and other bank debt. Finally, Enron's investment grade credit rating was critical to the scheme, as only Enron's insiders and its banks knew, because under the terms of the partnerships/SPE deals, ***if Enron's debt was downgraded to below investment grade, the debt of those entities that they had told the securities markets was non-recourse as to Enron would become recourse to Enron, which could cause the house of cards to topple***. As Enron's CFO stated in a 10/01 conference call, "***We understand that our credit rating is critical to both the capital markets as well as our counterparties***."

14. To manipulate and thus falsify Enron's financial condition and inflate its reported results, Enron, Andersen, Vinson & Elkins and several of Enron's banks engaged in a series of purported "partnership" and "related party" transactions, including those described below. Many of the entities Enron used to falsify its financial results were known as SPEs. A public company that

conducts business with an SPE may treat that SPE as if it were an independent entity ***only*** if it does not control the SPE. At a bare minimum, two conditions must be met: (i) an owner independent of the company must make an equity investment of ***at least 3% of the SPE's assets, and that 3% must remain at risk throughout the transaction***; and (ii) ***the independent owner must exercise control of the SPE.***

E. Abuse of Mark-to-Market Accounting

15. In addition to falsifying its financial results by engaging in transactions with SPEs that it secretly controlled, Enron engaged in several other accounting tricks and manipulations to falsify its financial results during the Class Period. Chief among these was the misuse and abuse of "***mark-to-market accounting***" (also known as "fair value accounting") whereby Enron would compute the purported economic value or profit it would ultimately obtain on a multi-year contract, discount that to present value and recognize the entire "mark-to-market" profit in the current period. Unless Enron's expected profit on the transaction was truly hedged, Enron was required in each following quarter to recompute or readjust the profit computation to adjust for changing economic values. "Mark-to-market" accounting was appropriate only where Enron had a long-term track record which gave it the ability to accurately estimate and forecast future values (as was true with certain aspects of Enron's wholesale energy business). However, Enron misused and abused mark-to-market accounting ***throughout its entire business to grossly inflate its reported revenues and profits during the Class Period***, a tactic furthered by the fact that Enron managers willing to engage in such falsifications were able to obtain larger bonuses based on the inflated values. In Enron's wholesale energy business this was done by assigning unrealistic values to wholesale energy transactions which inflated current period income. In Enron's new retail energy services operations where Enron had no long-term track record to justify the use of mark-to-market accounting, Enron nevertheless consistently utilized mark-to-market accounting to record huge current period profits on long-term, highly speculative retail energy risk-management contracts which, in fact, Enron had no basis to project a profit on and in fact knew would likely result in losses. Enron not only misused and abused mark-to-market accounting to initially value multi-year transactions to generate inflated current period profits, it also, when reviewing those computations on a quarterly basis as it was

required to do, consistently ***increased*** the estimated value of the transaction even though subsequent data revealed ***a reduction of the estimated value of the transaction, a practice known within the Company as "moving the curve."***

16. Another tactic utilized by Enron to falsify its financial condition and hide the true extent of its debt and liquidity involved transactions with certain of its banks – JP Morgan and CitiGroup. In the case of JP Morgan, these manipulations used an entity controlled by JP Morgan, known as "Mahonia," which was located in the Channel Islands off England. JP Morgan and Enron utilized a scheme which JP Morgan had originally utilized before with a commodities trader from Sumitomo, by which large bank loans are disguised to be commodity trades. In fact, offsetting trades were arranged with the ultimate cost differential being in favor of the bank, representing the interest rate on the disguised loan. Enron, Mahonia and JP Morgan got Vinson & Elkins to give a false legal opinion that these transactions were in fact legitimate commodities trades. Thus, by utilizing this manipulative device, JP Morgan and Enron falsified Enron's financial condition to make it appear much stronger than it really was, concealing some $3.9 billion in debt, which, had it been known and disclosed, would likely have resulted in Enron losing its investment grade credit rating with all the negative consequences that would flow from that. JP Morgan attempted to insure against default on those disguised loans by buying performance bonds from several insurance companies. However, the insurers refused to pay, alleging that in fact the commodity trades were fraudulent and a subterfuge to conceal the real nature of the transactions, *i.e.*, done for the purpose of disguising loans. ***A federal district court judge has ruled that there is significant evidence to support the insurers' claims of fraud and deception and that these transactions were, in fact, disguised loans.***

17. CitiGroup also engaged in subterfuges to disguise large loans to Enron to help Enron present a misleading picture of its liquidity, financial condition and balance sheet. CitiGroup lent Enron $2.4 billion in a series of "pre-paid" swaps via what were called "Delta" transactions because they were conducted through CitiGroup's Cayman Island subsidiary named "Delta." In a true swap, neither party receives all the agreed payments up front. However, in these transactions, CitiGroup paid an estimate of the fair value of its portion of the swaps – hundreds of millions of dollars each time – immediately, and Enron was obliged to repay the cash over five years. The transactions

perfectly replicated loans and were, in fact, loans – but Enron never disclosed them as such on its balance sheet. Enron kept the loans off its balance sheet by accounting for the loans from CitiGroup as "***assets from price risk management***" and as "***accounts receivable.***"

18. These prepay transactions began as early as 92. According to Appendix E to Robert Roach's testimony before the Permanent Subcommittee on Investigations on 7/23/02, the prepay contracts were as follows:

Prepay Transactions with Chase
US$ millions

Transaction Name	Issuance Date	Commodity	Chase Commitment	Amount
Chase I	Dec-92	Crude	$75.0	$75.0
Chase II	June-93	Crude	$230.0	$230.0
Chase III	Dec-94	Crude	$207.9	$207.9
Chase IV	Sep-95	Gas	$225.0	$225.0
Chase V	Dec-96	Gas/Crude	$350.0	$350.0
Chase VI	Dec-97	Gas	$300.0	$300.0
Chase VII	June-98	Gas	$250.0	$250.0
Chase VIII	Dec-98	Crude	$250.0	$250.0
Chase IX	Jun-99	Gas	$500.0	$500.0
Chase X	Jun-00	Gas	$650.0	$650.0
Chase XI	Dec-00	Gas	$165.0	$330.0
Chase XII	Sep-01	Gas	$350.0	$350.0

Prepay Transactions with Citigroup
US$ millions

Transaction Name	Issuance Date	Commodity	Citigroup Commitment	Amount
Citibank Delta Energy 1994	Sep-94	Crude	$125.0	$125.0
Roosevelt (Natural Gas)	Dec-98	Gas	$310.0	$310.0
Roosevelt (Crude Oil)	Dec-98	Crude	$190.0	$190.0
Roosevelt Extension	May-99	Crude	$125.0	$125.0
Truman	Jun-99	Crude	$250.0	$500.0

Truman Extension	Sep-00	Crude	$337.5	$675.0
Yosemite I	Nov-99	Crude	$37.5	$800.0
Nixon	Dec-99	Crude	$104.0	$331.4
Yosemite II	Feb-00	Crude	$16.0	$305.0
CLN I (Yosemite III)	Aug-00	Crude	$0.0	$500.0
Yosemite IV				
CLN II	May-01	Crude	$0.0	$500.0
Euro CLN	May-01	Crude	$0.0	$155.0
Sterling CLN	May-01	Crude	$0.0	$161.0
Citibank Natural Gas	Jun-01	Gas	$250.0	$250.0
			$1,745.0	$4,927.4
			$5,297.9	$8,645.3

The secret offshore JP Morgan "Mahonia" and CitiGroup "Delta" and other transactions eventually totaled more than $8 billion. Also astonishing about the Mahonia and Delta transactions is the way JP Morgan and CitiGroup were *"paid off"* to engage in this manipulative subterfuge. Based on Enron's purported investment grade credit rating, Enron could have borrowed money from banks at 3.75%-4.25%. However, in the phony Mahonia and Delta transactions, ***Enron paid JP Morgan and CitiGroup between 6.5%-7.0% for the disguised loans – a huge difference from the cost of a legitimate bank loan – which made these disguised loans hugely profitable for JP Morgan and CitiGroup***!

19. In addition to charging extortionate interest rates for engaging and participating in the Mahonia and Delta contrivances, both JP Morgan and CitiGroup took unusual steps to protect themselves financially against loss and what they knew were not only dubious but highly dangerous transactions. In the case of JP Morgan, it purchased security bond insurance (deceiving the insurance companies into thinking they were insuring commodity trades and not loans) and obtained other letters of credit from other financial institutions (deceiving them as well), while CitiGroup undertook to lay off substantial portions of its economic risk by selling Enron-linked securities as notes, including the concealed Delta loans in that package of linked securities.

Subsequent Disclosures

20. ***On 10/16/01, Enron shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion.*** Within days, *The Wall Street Journal* began an exposé of the JEDI, Chewco and the LJM SPEs, the SEC announced an investigation of Enron, and Fastow, Enron's CFO, resigned. In 11/01 Enron was ***forced to admit that Chewco had never satisfied the SPE accounting rules and – because JEDI's non-consolidation depended on Chewco's status – neither did JEDI, and Enron consolidated Chewco and JEDI retroactive to 97. Enron also admitted it had failed to correct $51 million in errors found by Andersen for 97. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive increase in its reported debt.*** Enron revealed that it was restating its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below:

ENRON ACCOUNTING RESTATEMENTS				
	1997	1998	1999	2000
Recurring Net Income Amount of Overstatement	$ 96,000,000	$113,000,000	$250,000,000	$ 132,000,000
Debt Amount of Understatement	$711,000,000	$561,000,000	$685,000,000	$ 628,000,000
Shareholders' Equity Amount of Overstatement	$313,000,000	$448,000,000	$833,000,000	$1,208,000,000

21. Partnerships, including Chewco, ***were used by Enron management to enter into transactions that Enron could not, or would not, do with unrelated commercial entities.*** Many of the most significant transactions were designed to ***accomplish favorable financial results, i.e., not to achieve bona fide economic objectives or to transfer risk.*** Other transactions were implemented improperly ***to offset losses.*** These transactions allowed Enron to conceal from the market ***very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged – that is, that a third party was obligated to pay Enron the***

amount of those losses, when in fact that third party was simply an entity in which only Enron had a substantial economic stake.

22. At end of the day, the Enron fiasco represents a massive wealth transfer from public investors, including individual and institutional investors, including pension funds and thousands of Enron employees who purchased Enron stock for their retirement, to corporate insiders, Wall Street bankers and the accounting and legal professionals who perpetrated the fraud.

JURISDICTION AND VENUE

23. The claims asserted herein arise under and pursuant to §§10(b) and 20(a) of the Securities Exchange Act of 1934 ("1934 Act") [15 U.S.C. §§78j(b), 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. §240.10b-5], §§11 and 15 of the Securities Act of 1933 ("1993 Act") [15 U.S.C. §§77k and 77o].

24. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§1331 and 1367; §27 of the 1934 Act [15 U.S.C. §78aa] and §22 of the 1933 Act [15 U.S.C. §77v].

25. Venue is proper in this District pursuant to §27 of the 1934 Act and §22 of the 1933 Act, and 28 U.S.C. §1391(b). Enron maintained its principal place of business in this District and many of the acts and practices complained of herein occurred in substantial part in this District.

26. In connection with the acts alleged in this complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

PARTIES

A. Court Appointed Lead Plaintiff

27. Court Appointed Lead Plaintiff, The Regents of the University of California, the nation's premier public research university, was founded in 1868 and is composed of 10 campuses with a mission of teaching, research and public service. The University has over 183,000 graduate and undergraduate students, three law schools, five medical schools and the nation's largest continuing education program. The University has more than 155,000 employees and is governed by a 26 member Board of Regents. The Regents oversee the management of a portfolio totaling

more than $54 billion. The investment funds managed consist of the University's retirement, defined contribution and endowment funds, including both actively managed equity portfolios and passively managed index funds. These investments provide substantial benefits to current and retired employees and support the University's mission of education, research and public services.

B. Plaintiffs

28. Plaintiff Washington State Investment Board (the "Washington Board") purchased publicly traded debt securities of Enron at artificially inflated prices as detailed in its Certification previously filed with the Court, including the 6.40% Notes due 7/15/2006 and 6.95% Notes due 7/15/2028, and has suffered substantial damage as a result thereof. The Washington Board is responsible for the management and investment of public and retirement funds for the State of Washington.

29. Plaintiff Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund ("Teamsters 175 & 505") purchased Enron securities at artificially inflated prices as detailed in its Certification previously filed with the Court, and has suffered substantial damage as a result thereof. Teamsters 175 & 505 is a Taft-Hartley pension fund which oversees the retirement savings of thousands of Teamsters and has approximately $225 million in assets.

C. Defendants and Related Parties

(1) Enron

30. Enron is not named as a defendant in this action as it has filed for protection pursuant to Chapter 11 of the U.S. Bankruptcy Code.

31. (a) Defendant Kenneth L. Lay ("Lay") was director of the Company and Chairman of the Board of Directors of Enron and was Chief Executive Officer at various times during the Class Period. Lay also served as Enron's Chief Executive Officer from 86 until 2/01.

(b) Defendant Jeffrey K. Skilling ("Skilling") was a director of the Company. Skilling also served as the Company's President and Chief Operating Officer until 2/01, when he became Chief Executive Officer of Enron.

(c) Defendant Andrew S. Fastow ("Fastow") was Chief Financial Officer of Enron until he was fired in 10/01. During the Class Period, while in possession of adverse undisclosed information about the Company, Fastow sold 24,930 shares of his Enron stock for $657,529 in illegal insider trading proceeds.

(d) Defendant Richard A. Causey ("Causey") was Executive Vice President and Chief Accounting Officer of Enron.

(e) Deleted.

(f) Defendant Mark A. Frevert ("Frevert") was, during the Class Period, Chairman and Chief Executive Officer of Enron Europe from 3/97-6/00.

(g) Defendant Stanley C. Horton ("Horton") was Chairman and Chief Executive Officer of Enron Transportation Services. During the Class Period, while in possession of adverse undisclosed information about the Company, Horton sold 49,980 shares of his Enron stock for $1,137,045 in illegal insider trading proceeds.

(h) Defendant Kenneth D. Rice ("Rice") was, during the Class Period, Chairman and Chief Executive Officer of Enron Capital & Trade ("ECT")-North America from 3/97 until 6/99.

(i) Defendant Richard B. Buy ("Buy") was Management Director and Chief Risk Officer of ECT from 1/98-3/99. Buy previously worked for Bankers Trust, now part of Deutsche Bank.

(j) Defendant Lou L. Pai ("Pai") was Chairman and Chief Executive Officer of Enron Accelerator, and prior to that Pai was a director of EES and was involved in setting up some of the bad deals.

(k) Defendant Joseph M. Hirko ("Hirko") was, at all relevant times, Chief Executive Officer of Enron Communications.

(l) Defendant Ken L. Harrison ("Harrison") was, at all relevant times, Chief Executive Officer of Portland General Electric (a subsidiary of Enron) until 3/31/00, and was a director of Enron. During the Class Period, while in possession of adverse undisclosed information about the Company, Harrison sold 41,800 shares of his Enron stock for $1,076,350 in illegal insider trading proceeds.

(m) Defendant Steven J. Kean ("Kean") was Senior Vice President of Government Affairs of Enron during the Class Period.

(n) Deleted.

(o) Defendant Jeffrey McMahon ("McMahon") was Senior Vice President, Finance and Treasurer from 7/98-7/99, and from 94-7/98 was Chief Financial Officer of Enron Europe.

(p) Defendant Cindy K. Olson ("Olson") was, during the Class Period, Senior Vice President, Corporate Affairs and Workforce Diversity of Enron. Before becoming Senior Vice President, Olson worked for 15 years as an accountant and was therefore quite capable of understanding the intricacies of the fraud. *See* "Did HR Fuel the Demise of Enron? Jane Lewis Examines the Risk Taking, Entrepreneurial Work Culture of the Energy Giant and Shows How HR Played a Leading Role," *Personnel Today*, 3/19/02. Indeed, Olson's employment history at Enron demonstrates she was highly sophisticated and was able to understand the complex, fraudulent structures created. She had served as vice president of Wholesale Operations Services for Enron Capital & Trade Resources (ECT), where she was "responsible for deal capture and documentation, risk management administration, logistics and client services for ECT's wholesale operations." She also served in various management capacities within Enron's interstate pipeline companies, including vice president of Finance, Planning and Administration for Transwestern Pipeline, and vice president for Enron's Gas Accounting and Gas Management functions. Olson joined Enron in 79 in the Northern Natural Gas Corporate Auditing Department. Enron Press Release, 10/11/96.

(q) Defendant Joseph W. Sutton ("Sutton") was, at all relevant times, Vice Chairman of Enron until early 01. During the Class Period, while in possession of adverse undisclosed information about the Company, Sutton sold 12,600 shares of his Enron stock for $340,400 in illegal insider trading proceeds.

(r) Defendant Mark E. Koenig ("Koenig") was, at all relevant times, Executive Vice President, Investor Relations of Enron.

(s) Defendant Kevin P. Hannon ("Hannon") was, until his resignation in 8/01, Operating Officer of Enron Communications. Hannon previously was Enron's president of trading and commodities business. At Hannon's request, he was not considered an officer of Enron specifically so he could avoid reporting his stock sales.

(t) Defendant Lawrence Greg Whalley ("Whalley") was President and Chief Operating Officer of Enron Capital Wholesale Services. Whalley was not considered an officer of Enron (at his request), so that his stock sales would not have to be reported.

(u) Defendant Robert A. Belfer ("Belfer") was at all relevant times, a director of Enron. During the Class Period, while in possession of adverse undisclosed information about the Company, Belfer sold 7,360 shares of his Enron stock for $195,040 in illegal insider trading proceeds.

(v) Defendant Norman P. Blake, Jr. ("Blake") was, at all relevant times, a director of Enron.

(w) Defendant Ronnie C. Chan ("Chan") was, at all relevant times, a director of Enron.

(x) Defendant John H. Duncan ("John Duncan") was, at all relevant times, a director of Enron.

(y) Defendant Wendy L. Gramm ("Gramm") was, at all relevant times, a director of Enron. During the Class Period, while in possession of adverse undisclosed information about the Company, Gramm sold 7,760 shares of her Enron stock for $191,090 in illegal insider trading proceeds.

(z) Defendant Robert K. Jaedicke ("Jaedicke") was, at all relevant times, a director of Enron.

(aa) Defendant Charles A. LeMaistre ("LeMaistre") was, at all relevant times, a director of Enron.

(bb) Defendant Joe H. Foy ("Foy") was, at all relevant times, a director of Enron until 6/00.

(cc) Defendants Jerome J. Meyer ("Meyer"), John A. Urquhart ("Urquhart"), John Wakeham ("Wakeham"), Charls E. Walker ("Walker") and Herbert S. Winokur, Jr. ("Winokur") were directors of Enron. Urquhart was also senior advisor to the Chairman in 98. These directors are defendants only as to the claims alleged under §11 of the 1933 Act. Each of these defendants signed Registration Statements issued pursuant to Enron's debt and equity offerings made during the

Class Period. As described herein, such Registration Statements contained false and misleading statements as to Enron's business, liquidity and financial results.

(dd) The individuals named as defendants in ¶¶31(a)-(cc) are referred to herein as the "Enron Defendants." Because of their positions with the Company, each Enron Defendant had access to the adverse non-public information about the Company's business, finances, products, markets and present and future business prospects via access to internal corporate documents (including the Company's product sales, operating plan, budget and forecast and product sales reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management and Board of Directors meetings and committees thereof and via reports and other information provided to them in connection therewith.

32. As officers, directors and/or controlling persons of a publicly held company whose stock is registered with the SEC under the 1934 Act and traded on the New York Stock Exchange, the Enron Defendants had a duty to promptly disseminate accurate and truthful information with respect to the Company's operations, business, products, markets, management, earnings, and present and future business prospects, to cause Enron's financial statements to fairly present its financial condition and results from operations in conformity with GAAP, to correct any previously issued statements that had become untrue and to disclose any adverse trends that would materially affect the present and future financial operating results of the Company, so that the market price of the Company's stock would be based upon truthful and accurate information. During the Class Period, the Enron Defendants engaged in illegal insider trading, selling over 227,000 shares of their Enron stock at prices inflated by their fraudulent scheme and while in possession of material adverse non-public information, pocketing over $5 million in illegal insider trading proceeds. The collective insider selling by the officers and directors of Enron before and during the Class Period is shown below:

Enron Corp.
Summary of Class Period Insider Sales
(all share amounts are adjusted for the
Company's 8/13/99 2-for-1 stock split)

INSIDER	SHARES SOLD	PROCEEDS
Belfer	7,360	$195,040
Fastow	24,930	$657,529
Gramm	7,760	$191,090
Harrison	41,800	$1,076,350
Horton	49,980	$1,137,045
Mark-Jusbasche	83,072	$2,077,487
Sutton	12,600	$340,400
TOTAL:	227,502	$5,674,941

33. Enron's Board of Directors used working committees to oversee and control Enron's business. These committees met frequently and received detailed written and oral reports concerning those parts of Enron's business within their purview. They were:

(a) The Audit Committee, which worked with Enron's auditors, as well as Enron officers and employees who were responsible for legal, financial and accounting matters. It approved the appointment of Andersen as Enron's "independent" auditor and the Audit Committee reviewed and approved the accounting policies and reporting practices, internal auditing and internal controls, and compliance with Enron's policies regarding business conduct.

(b) The Finance Committee monitored, reviewed and approved Enron's financial activities. The Finance Committee reviewed the financial plans and proposals of Enron's management.

(c) The Executive Committee met on a frequent basis to oversee and review Enron's business and had the power to exercise all of the powers of the Board of Directors.

34. The Enron directors listed below served on the Enron Board of Directors and the indicated Board Committees for the periods indicated:

Director/Period		Committees
Robert A. Belfer	1983-2001	Executive 1995-2001, Finance 1997-2001
Norman P. Blake	1993-2001	Audit 1995-1996, Finance 1995-2001
Ronnie C. Chan	1996-2001	Audit 1997-2001, Finance 1997-2001
John H. Duncan	1985-2001	Executive (chair) 1995-2001
Joe H. Foy	1985-2000	Executive 1995-2000, Audit 1997-2000
Wendy L. Gramm	1993-2001	Audit 1995-2001
Ken L. Harrison	1998-2000	None
Robert K. Jaedicke	1985-2001	Audit (chair) 1995-2001, Finance 1995-1996
Kenneth L. Lay	1985-2002	Executive 1995-2002
Charles A. LeMaistre	1985-2001	Executive 1995-2001
Jerome J. Meyer	1998-2001	Finance 1998-2001
Jeffrey K. Skilling	1997-2001	Executive 1998-2001
John A. Urquhart	1990-2001	Finance 1995-2001
John Wakeham	1994-2001	Audit 1995-2001
Charls E. Walker	1985-2000	Finance 1995-1999
Herbert S. Winokur, Jr.	1985-2001	Executive 1995-2001, Finance (chair) 1995-2001

35. The day-to-day business of Enron was conducted by Enron's top executives and its "Management Committee," a collection of top officers who met regularly (weekly or bi-weekly) to oversee and review Enron's business. The Management Committee was aware of and approved all significant business transactions of Enron, including each of the partnership/SPE deals specified herein. The Enron Defendants' roles on the Enron Management Committee during 97-98 are set forth below:

Enron Management Committee – 97

Rice, Causey, Hannon, Kean, Harrison, Koenig, Skilling, Fastow, Hirko, Lay, Sutton, Frevert, Horton, Pai and Urquhart.

Enron Management Committee – 98

Frevert, Buy, Kean, Rice, Hannon, Koenig, Causey, Harrison, Lay, Skilling, Hirko, Sutton, Fastow, McMahon, Horton, Olson, Urquhart and Pai.

36. It is appropriate to treat the Enron Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed in the Company's public filings, press releases and other publications, as alleged herein, are the collective actions of the Enron Defendants identified above. Each of the above officers and directors of Enron, by virtue of their high-level positions with the Company, participated in the management of the Company and its business, operations, financial statements, and financial condition, as alleged herein. Each of the

Enron Defendants is responsible for the accuracy of the public reports and releases detailed herein and is therefore primarily liable for the representations contained therein.

37. The Enron Defendants, because of their positions of authority as officers and/or directors of the Company, were able to and did control the content of various SEC filings, press releases and other public statements pertaining to the Company during the Class Period. Each Enron Defendant was provided with copies of the documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected.

(2) Andersen

38. The various offices of Arthur Andersen LLP and Andersen Worldwide, S.C. and the Andersen partners and employees described below in ¶39(a)-(k) are collectively referred to as "Andersen."

39. (a) Defendant Andersen Worldwide, S.C. ("Andersen-Worldwide" or "AWO") is comprised of Société Coopérative, Switzerland, a partnership organized under the Swiss Federal Code of Obligations ("AWSC"), the AWO member firms and the partners of AWSC. Andersen-Worldwide partners included more than 4,800 individuals from 390 offices in 84 countries. Various individuals who were partners of Andersen-Worldwide participated in the 97-00 audits of Enron. Andersen-Worldwide and Arthur Andersen LLP dictated the policies and procedures to be used within Andersen throughout the world.

(b) Defendant Arthur Andersen LLP is part of Andersen-Worldwide, S.C. Andersen is a partnership formed under the laws of the State of Illinois. The partners of Andersen are residents of numerous states. Andersen participated in and coordinated the 96-97 audits of Enron. In addition, Andersen partners and employees provided consulting services to Enron. Andersen was convicted on 6/15/02 of obstruction of justice in connection with its destruction of Enron related documents.

(c) Defendant Andersen Co. ("Andersen-India") is part of Andersen-Worldwide. Andersen-India participated in the 97-00 audits of Enron.

(d) Defendant Arthur Andersen-Brazil ("Andersen-Brazil") is part of Andersen-Worldwide. Andersen-Brazil participated in the 97-00 audits of Enron.

(e) Defendant Arthur Andersen ("Andersen-United Kingdom") is part of Andersen-Worldwide. Andersen-United Kingdom participated in the 97-00 audits of Enron. Andersen-United Kingdom has been implicated in the document shredding indictment, indicating an awareness of possible wrongdoing in connection with work for Enron.

(f) Deleted.

(g) Defendant David B. Duncan ("David Duncan") was the lead Andersen partner since 97 on the Enron engagement – David Duncan's only client. David Duncan's compensation was directly tied to the fees generated on the Enron engagement which was personally and professionally beneficial to David Duncan. David Duncan was a partner in both Andersen-Worldwide and Andersen. Andersen fired David Duncan on or about 1/15/02.

(h) Defendant Debra A. Cash ("Cash"), a partner of Andersen, was head of the lucrative energy unit in the Houston office and was an integral part of the Enron audit and consulting engagements.

(i) Defendant David Stephen Goddard, Jr. ("Goddard") was the managing partner for the Houston office since 97 and was in charge of Andersen's Audit & Business Advisory and Energy practice for the Houston office. Goddard was an integral part of the Enron audit and consulting engagements. Goddard was also the managing partner for the Gulf Coast Market Circle. Goddard was a partner in both Andersen-Worldwide and Andersen.

(j) Defendant Gary B. Goolsby ("Goolsby") was Andersen's partner in charge of Global Risk Management and Consulting Practice Director of the Houston office. Goolsby was an integral part of the Enron audit and consulting engagements. Goolsby was relieved of his management responsibilities on 1/15/02.

(k) Defendant Michael M. Lowther ("Lowther") was Andersen's concurring partner on the Enron audit since 97. Lowther was an integral part of the Enron audit and consulting engagements. Lowther was a partner in both Andersen-Worldwide and Andersen. Lowther was relieved of his management responsibilities on 1/15/02.

40. Each defendant listed in ¶39(g)-(k) was a partner and/or employee of Andersen. They were involved in the audits and consultations of Enron and had knowledge of the adverse facts as pleaded at ¶¶106-168.

41. A more detailed description of Andersen's involvement and its failure to comply with Generally Accepted Auditing Standards ("GAAS") is found in ¶¶286-321.

(3) The Law Firm

42. Defendant Vinson & Elkins L.L.P. ("Vinson & Elkins") was Enron's outside general counsel during the Class Period. Enron was Vinson & Elkins's largest client. Vinson & Elkins participated in structuring Enron's illicit partnerships (Chewco/JEDI) and the bogus SPEs knowing these were manipulative devices being used to falsify Enron's reported financial results and financial condition. Vinson & Elkins repeatedly issued false opinions on these transactions – that they were "true sales" or otherwise legitimate business transactions – when they were, in fact, manipulative contrivances designed to artificially boost Enron's reported profits and hide billions of dollars of debt that belonged on Enron's balance sheet.

(4) Investment Banks

43. Each of the bank holding company entities sued as defendants herein conducts its business affairs through a series of wholly owned and controlled subsidiaries where the bank holding company directly or indirectly owns 100% of the stock of the subsidiaries and completely directs and controls their business operations through the selection and appointment of their officers and, where necessary, directors. These controlled subsidiaries are also the agents of the bank holding company entities and include investment bank subsidiaries as well as other specialized subsidiaries rendering financial advice and services to public companies, including Enron. The financial operations and condition of these subsidiaries are – for financial reporting and other purposes – consolidated with the bank holding company's financial statements. Thus, all revenues, earnings and income of the bank holding company subsidiaries are upstreamed to and belong to the bank holding companies. The bank holding companies named as defendants in this action all participated in the fraudulent scheme and course of business complained of, not only by way of the actions of the holding company

itself, but also by way of the actions of numerous of its controlled subsidiaries and agents, some of which have been named as defendants in this action as well.

44. (a) Defendant J.P. Morgan Chase & Co. is an integrated financial services institution that through known and unknown subsidiaries, divisions and/or affiliates acting as the agent of and controlled by J.P. Morgan Chase & Co., such as, but not limited to, JP Morgan Securities Inc. and JP Morgan Chase Bank (collectively, "JP Morgan") provides commercial and investment banking services and advisory services, including acting as underwriter in the sale of corporate securities and providing investment analysis and opinions on public companies. JP Morgan engaged and participated in the scheme to defraud purchasers of Enron securities and Enron's course of business which operated as a fraud and deceit on purchasers of Enron's securities by rendering all of the above services to Enron as described in greater detail in the section of this Complaint entitled "Involvement of JP Morgan." In addition to J.P. Morgan Chase & Co., the following subsidiaries, divisions and/or affiliates, acting at the direction of and under the control of J.P. Morgan Chase & Co., are specifically named as defendants:

(b) JP Morgan Chase Bank, successor of The Chase Manhattan Bank (collectively, "JP Morgan Chase Bank") – under the control of J.P. Morgan Chase & Co. – acted (as is detailed further in the section of this Complaint entitled "Involvement of JP Morgan") to further the defendants' fraudulent scheme by substantially financing deceptive devices created for the purpose of falsifying Enron's reported financial disclosures, including: the Mahonia transactions and Chewco's purchase of an outside investors' equity interest in JEDI.

(c) JP Morgan Securities Inc., successor of Chase Securities Inc. (collectively, "JPMSI") – under the control of J.P. Morgan Chase & Co. – acted as an underwriter of certain Enron and Enron affiliated entity securities, including: Enron's 10/97 6.625% notes due 10/03; Enron's 5/98 34.5 million shares common stock offering; and Enron's 7/98 6.4% Notes due 7/15/06 and 6.95% Notes due 7/15/28.

45. (a) Defendant CitiGroup, Inc. is a large integrated financial services institution that through known and unknown subsidiaries, divisions and/or affiliates acting as the agent of and controlled by CitiGroup, Inc., such as, but not limited to, Salomon Smith Barney, Inc. and Citibank,

N.A. (collectively, "CitiGroup") provides commercial and investment banking services, commercial loans to corporate entities, and advisory services regarding the structuring of financial transactions, including engaging in or helping to structure derivatives and hedging financial transactions, acting as underwriter in the sale of corporate securities to the public and providing investment analysis and opinions on public companies, including its clients, via reports issued by securities analysts. CitiGroup engaged and participated in the scheme to defraud purchasers of Enron securities and Enron's course of business which operated as a fraud and deceit on purchasers of Enron's securities by rendering all of the above services to Enron as described in greater detail in the section of this Complaint entitled "Involvement of CitiGroup." In addition to CitiGroup, Inc., the following subsidiaries, divisions and/or affiliates, acting at the direction of and under the control of CitiGroup, Inc., are specifically named as defendants:

(b) Citibank, N.A. ("Citibank") – under the control of CitiGroup, Inc. – acted (as is detailed further in the section of this Complaint entitled "Involvement of CitiGroup") to further the defendants' fraudulent scheme by substantially financing several of Enron's disguised loans hidden as prepaid swap transactions with CitiGroup's Cayman Island entity known as Delta Energy Corp., including Roosevelt and Truman. Citibank also played a primary role in several of the other fraudulent transactions designed to falsify Enron's reported financial results, including: the Nighthawk, Rawhide, and Nahanni transactions (minority interest financings by which CitiGroup secretly funneled approximately $1.75 billion in loans to Enron such that the loans did not appear on Enron's balance sheet as debt but as a minority interest in a consolidated subsidiary).

(c) Salomon Smith Barney, Inc. ("Salomon") – now under the control of CitiGroup, Inc. – is the successor to Salomon Brothers. Salomon acted (as is detailed further in the section of this Complaint entitled "Involvement of CitiGroup") to further the defendants' fraudulent scheme by repeatedly issuing throughout the Class Period false and misleading statements in its analyst research reports. Further, prior to and during the Class Period, Salomon acted as an underwriter of certain Enron and Enron affiliated entity securities, including: Enron's 9/98 Floating-rate Notes due 3/30/00; and Enron's 11/97 6.45% Notes due 11/15/01.

46. (a) Defendant Barclays PLC is a large integrated financial services institution that through known and unknown subsidiaries, divisions and/or affiliates acting as the agent of and under the control of Barclays PLC, such as Barclays Bank PLC and Barclays Capital, Inc. (collectively, "Barclays"), provides commercial and investment banking services, commercial loans to corporate entities, and advisory services regarding the structuring of financial transactions, including engaging in or helping to structure derivatives and hedging financial transactions, acting as underwriter in the sale of corporate securities to the public and providing investment analysis and opinions to its clients. Barclays engaged and participated in the scheme to defraud purchasers of Enron securities and Enron's course of business which operated as a fraud and deceit on purchasers of Enron's securities by rendering all of the above services to Enron as described in greater detail in the section of this Complaint entitled "Involvement of Barclays." In addition to Barclays PLC, the following subsidiary, division, and/or affiliate, acting at the direction of and under the control of Barclays PLC, is specifically named as a defendant:

(b) Barclays Bank PLC – under the control of Barclays PLC – acted (as is detailed further in the section of this Complaint entitled "Involvement of Barclays") to further the defendants' fraudulent scheme by disguising debt financing provided to Enron affiliated entities (including Chewco, Big River Funding LLC and Little River Funding LLC) for the purposes of entering into transactions with Enron that were known to Barclays Bank PLC to be fraudulent. Additionally, Barclays Bank PLC played a primary role in the fraudulent Class Period transactions known as the Cash 6 transaction (detailed in the Second Interim Report by Enron's Bankruptcy Examiner).

47. (a) Defendant Deutsche Bank AG is a large integrated financial services institution that through known and unknown subsidiaries, divisions, and/or affiliates acting as the agent of and under the control of Deutsche Bank AG, such as Deutsche Bank Securities Inc., DB Alex. Brown LLC, and Deutsche Bank Trust Company Americas (collectively, "Deutsche Bank"), provides commercial and investment banking services, commercial loans to corporate entities, and advisory services regarding tax shelters and the structuring of financial transactions, including engaging in or helping to structure derivatives and hedging financial transactions, acting as underwriter in the sale of corporate securities to the public and providing investment analysis and

opinions on public companies, including its clients, via reports issued by securities analysts. Deutsche Bank engaged and participated in the scheme to defraud purchasers of Enron securities and Enron's course of business which operated as a fraud and deceit on purchasers of Enron's securities by rendering all of the above services to Enron as described in greater detail in the section of this Complaint entitled "Involvement of Deutsche Bank." In addition to Deutsche Bank AG, the following subsidiary, division and/or affiliate, acting at the direction of and under the control of Deutsche Bank AG is specifically named as a defendant:

(b) Deutsche Bank Trust Company Americas – a wholly owned subsidiary of Deutsche Bank AG through multiple subsidiaries – is the successor of Bankers Trust Company, which was acquired by Deutsche Bank AG on 6/4/99 in the Deutsche Bank acquisition of BT Alex. Brown. Bankers Trust and Deutsche Bank Trust Company Americas (collectively referred to herein as "Bankers Trust") – acted (as is detailed further in the section of this Complaint entitled "Involvement of Deutsche Bank") to further the defendants' fraudulent scheme by creating and implementing fraudulent tax schemes designed to artificially inflate Enron's reported financial results. At all times after its acquisition, Bankers Trust was controlled by Deutsche Bank AG.

48. (a) Defendant Lehman Brothers Holding, Inc. is a large integrated financial services institution that through known and unknown subsidiaries, divisions, and/or affiliates acting as the agent of and under the control of Lehman Brothers Holding, Inc., such as Lehman Brothers Inc. and LBI Group Inc. (collectively, "Lehman Brothers"), provides commercial and investment banking services, commercial loans to corporate entities, and advisory services regarding the structuring of financial transactions, including engaging in or helping to structure derivatives and hedging financial transactions, acting as underwriter in the sale of corporate securities to the public and providing investment analysis and opinions on public companies, including its clients, via reports issued by securities analysts. In addition to Lehman Brothers Holding, Inc., the following subsidiary, division and/or affiliate, acting at the direction of and under the control of Lehman Brothers Holding, Inc., is specifically named as a defendant:

(b) Lehman Brothers Inc.– under the control of Lehman Brothers Holding, Inc. – acted (as is detailed further in the section of this Complaint entitled "Involvement of Lehman

Brothers") to further the defendants' fraudulent scheme by underwriting certain Enron and Enron affiliated entity securities, including: Enron's 7/7/98 6.4% Notes due 7/15/06 and 6.95% Notes due 7/15/28.

¶¶49-52 Deleted.

PRE-CLASS PERIOD STATEMENTS

53. On 4/11/97, Enron reported its 1stQ 97 results in a release that stated:

> Enron Corp. today reported first quarter1997 earnings per share of $[0.44] after preferred dividends, compared to $[0.43] in the first quarter of 1996. Total net income in the first quarter of 1997 was $222 million compared to $213 million for the same period in 1996. Revenues in the first quarter of 1997 were $5.3 billion compared to revenues of $3.1 billion in the first quarter of 1996.
>
> "Enron's financial performance in the first quarter of 1997 reflected solid contributions from each of our business units and we remain on track to achieve our targeted 10 to 15 percent growth in earnings per share this year," said Kenneth L. Lay, chairman and chief executive officer of Enron.

54. On 7/15/97, Enron reported its 2ndQ 97 results in a release which stated:

> Enron Corp. today reported second quarter 1997 primary earnings per share from operations of $[0.20] after preferred dividends (exclusive of the non-recurring charges discussed below), compared to $[0.23] in the second quarter of 1996. Income from operations in the second quarter of 1997 was $104 million (exclusive of the non-recurring charges) compared to net income of $117 million for the 1996 period.
>
> * * *
>
> "The earnings effect of the J-block settlement makes this a disappointing quarter," said Kenneth L. Lay, chairman and chief executive officer of Enron. "But the settlement is clearly beneficial to the company's longer-term prospects and should not obscure the tremendous performance and even stronger growth potential displayed by our wholesale natural gas and electricity businesses and international development business. In the second quarter, these two segments showed strong earnings growth. Further, during the last six months, we have laid a solid foundation for our emerging retail and renewable energy businesses. We are more encouraged than ever that these new businesses will be significant contributors to the company's stock price, even in the near term."

55. On 8/14/97, Enron filed its Form 10-Q for the 2ndQ 97, signed by Causey. The Form 10-Q included a balance sheet, on which Enron reported it had total debt of only $4.5 billion at 6/30/97.

56. In fact, Enron was concealing billions in debt through phony prepay contracts arranged by JP Morgan and CitiGroup, as described in ¶¶117-125, 177, 184-187 and 194.

57. On 9/9/97 (the beginning of the Class Period), the statements pleaded in ¶¶53-55 were alive, impacting and inflating the market price of Enron's publicly traded securities. Each of the statements made between 4/11/97 – 9/9/97 were false or misleading when issued. The true but concealed facts were:

(a) Enron's financial statements and results issued during this period were false and misleading as they inflated Enron's revenues and earnings to conceal billions of dollars of debt that should have been shown on Enron's balance sheet, as described in ¶¶106-140, 167-168.

(b) Enron's financial condition, including its liquidity and credit standing, was not nearly as strong as represented, as Enron was concealing billions of dollars of debt that should have been reported on its balance sheet – and which would have very negatively affected its credit rating, financial condition and liquidity – by improperly transferring that debt to the balance sheets of various non-qualifying SPEs and partnerships it secretly controlled, as detailed herein.

(c) The results of Enron's wholesale (WEOS) business – its largest business unit – were manipulated and falsified to boost its reported profitability in various ways. ***First***, by phony or illusory hedging transactions with entities that were not independent of Enron. ***Second***, by the abuse of mark-to-market accounting by adopting unreasonable contract valuations and economic assumptions when contracts were initially entered into. And ***third***, by arbitrarily adjusting those values upward at quarter's end to boost the wholesale operation's profits for that period – a practice known inside Enron as "moving the curve." And Enron had not effectively hedged its WEOS merchant investment portfolio as most of the purported hedges were with non-independent parties in transactions structured such that the hedge depended on Enron stock and thus Enron was still at risk.

(d) Under Mark-Jusbasche, Enron International repeatedly deferred capital expenditures, including developer, financing and promotional fees, that were incurred on failed project proposals. For more than five years – between 93 and 97 – these deferred expenses were accumulated – a practice known inside Enron as "***snowballing***" – and very few write-offs were taken. Costs for South African projects involving oil and gas reserves, pipelines, and a plant designed to convert ore into another form of energy, and projects in China, among others, were "***snowballing***" quickly – the cash burn rate was as much as ***one million dollars a month*** – but not being expensed. As former executives explained, quarter after quarter, year after year, Enron International "***got pressure from corporate about meeting earnings,***" which prohibited write-offs – even when it was clear that the proposed project would never go forward. Consequently, the "***snowball***" grew exponentially – so large that an international accounting officer repeatedly told Enron's CAO Causey that a writedown ***had to be taken because so many proposals were no longer even arguably viable.*** But this ran counter to corporate directives. Causey, at ***Skilling's direction, routinely responded that "corporate didn't have room" to take a write-off because doing so would bring Enron's earnings below expectations***. By 97, years past when start-up and proposal costs should have been written off, ***Enron had deferred a $100-million "snowball"*** on some 75 projects, including those in Central and South America and the Dabhol power plant in India, while the cash-burn rate – virtually all deferred – dwarfed the revenue return.

(e) It was impossible for EES to enter into contracts that extended beyond three years and accurately forecast energy costs or savings because of the variables related to these contracts. Enron misused these variables in long-term contracts to manipulate its assumptions – "moving the curve" to create higher values and thus record higher revenues using mark-to-market accounting.

CLASS PERIOD EVENTS AND FALSE STATEMENTS

58. On 9/12/97, Enron filed a Form S-3 with the SEC to register $1 billion Enron Corp. Debt Securities, Warrants, Preferred Stock and Depositary Shares which contained Enron's 2ndQ 97 results and incorporated Enron's Form 10-K for 96. As described in ¶¶106-168, these financial results were false. The Registration Statement was signed by Lay, Causey, Fastow, Belfer, Blake, John Duncan, Foy, Gramm, Jaedicke, LeMaistre, Meyer, Skilling, Urquhart, Wakeham, Walker and Winokur.

59. On 10/14/97, Enron reported its 3rdQ 97 results in a release that stated in part:

> Enron Corp. today reported third quarter 1997 net income of $134 million, or primary earnings per share of $[0.22], compared to net income of $123 million, or $[0.24] per share, for the 1996 period. Revenues for the third quarter of 1997 were $5.8 billion compared to $3.2 billion for the prior year quarter.

"The third quarter results reflect strong increases in earnings from our international operations and development businesses and our Enron Capital & Trade Resources businesses," said Kenneth L. Lay, chairman and chief executive officer of Enron. "All of our business units made excellent progress on key activities that are building value for investors and contributing to Enron's long-term growth strategies."

60. On 10/15/97, Merrill Lynch issued a report on Enron, which rated Enron a "Buy," forecast 98 EPS of $[1.25] and stated:

Enron Corp Third Quarter: A Nice Surprise

ENE reported 13% Higher Q3 Operating Earnings

ENE had a "clean" Q3-97, reporting EPS of $[0.22] vs. Operating EPS of $[0.19] in Q3-96 and our estimate of $[0.18]. The higher results were driven by higher earnings from Capital & Trade Resources (ECT) and International.

* * *

Imputing market multiples on our 98E and 99E earnings mixes, values the stock at about $[21.625] in the next 12 months and about $[23.115] in the next 12-18 months.

61. On 10/15/97, CS First Boston issued a report on Enron, which rated Enron a "Buy," forecast 98 EPS of $[1.25] and a 15% five-year EPS growth rate for Enron and stated:

Enron International contributed $65 million in EBIT vs. $38 million in 3Q '96. This increase can be attributed to earnings from the development of the numerous power projects and increased value in Enron International's investment portfolio. Enron International recent successful bid to provide 1000MW of electricity to be transported from Argentina to Brazil provides continued evidence of Enron's ability to create new growth opportunities worldwide.

62. On 10/16/97, CIBC issued a report on Enron, which rated Enron a "Market Perform," forecast 98 EPS of $[1.20] and stated:

While near-term earnings visibility remains somewhat uncertain, Enron remains well positioned in two of the most powerful global energy themes now under way: 1) the deregulation of wholesale and retail energy markets in developed economies, and 2) the privatization of energy infrastructure in emerging economies. Accordingly, we continue to believe longer term earnings power will build at rates above its peer group and would consider accumulating the shares on any pullbacks near $[18.50].

63. On 10/20/97, Enron sold $100 million of 6.625% Notes due 10/15/2003, with JP Morgan acting as underwriter. The Prospectus also included Enron's 3rdQ 97 results. In fact, these financial results were false. Enron used the proceeds of this securities issuance to pay down its existing debt.

64. On 11/6/97, Enron sold $200 million of Remarketed Reset Notes due 11/15/2037, with Merrill Lynch acting as underwriter. The Prospectus also included Enron's 3rdQ 97 results. In fact, these financial results were false. Enron used the proceeds of this securities issuance to pay down its existing debt.

65. On 11/14/97, Enron filed its Form 10-Q for the 3rdQ 97 with the SEC. The Form 10-Q, signed by Causey, represented that Enron had long-term debt of only $6.9 billion at 9/30/97.

66. In fact, Enron had billions of dollars more in undisclosed debt due to phony prepay contracts arranged by JP Morgan and CitiGroup, as described in ¶¶117-125, 177, 184-187 and 194.

67. On 11/13/97, Enron sold $300 million of 6.45% Notes due 11/15/01, with CitiGroup acting as underwriter. The Prospectus also included Enron's 3rdQ 97 results. In fact, these financial results were false. Enron used the proceeds of this securities issuance to pay down its existing debt.

68. On 11/19/97, Enron sold $250 million of 6.625% Notes due 2005, with Bank America acting as underwriter. The Prospectus also included Enron's 3rdQ 97 results. In fact, these financial results were false. Enron used the proceeds of this securities issuance to pay down its existing debt.

69. By 12/97, Enron's stock price had increased to nearly $21 per share compared to approximately $18 at the beginning of the Class Period.

70. On 12/19/97, Enron filed a Form S-3 with the SEC to the register $1 billion Enron Corp. Debt Securities, Warrants, Preferred Stock and Depositary Shares which contained Enron's 3rdQ 97 results and incorporated Enron's Form 10-K for 96. As described in ¶¶106-168, these financial results were false. The Registration Statement was signed by Lay, Causey, Fastow, Belfer, Blake, Chan, John Duncan, Foy, Gramm, Harrison, Jaedicke, LeMaistre, Meyer, Skilling, Urquhart, Wakeham, Walker and Winokur.

71. On 1/20/98, Enron reported its 97 results in a release which stated in part:

> Enron reported 1997 net income of $105 million compared with $584 million in 1996. The corresponding diluted earnings per share were $0.32 and $2.16 for 1997 and 1996, respectively. Basic earnings per share were $0.32 and $2.31 for 1997 and 1996, respectively.
>
> "Our 1997 results reflected extremely strong operating performance in virtually all of our business units, offset to a significant degree by a number of non-

recurring changes," said Kenneth L. Lay, Enron Corp. chairman and CEO. "These charges allow us to clear the decks for future growth."

72. On 1/20/98, CS First Boston issued a report on Enron, which rated Enron a "Buy," forecast 98 EPS of $[1.25] and a 15% five-year EPS growth rate for Enron and stated:

> Enron's core businesses reported 1997 diluted earnings of $[.99] in 1997 compared with $[.91] in 1996. EBIT from Exploration and Production was $183 million in 1997 compared with $200 million in 1996. These results reflect increased production volumes, increased average natural gas prices, and losses associated with EOG price hedging activities.
>
> * * *
>
> Enron's investment in its Energy Services division (EES) continues to make significant advancement in rapidly expanding its customer base.
>
> * * *
>
> This is the company/management team which built (virtually pioneered) the No. 1 wholesale gas marketing company in North America, and is responsible for many industry leading innovations.

73. On 3/31/98, Merrill Lynch issued a report on Enron, which rated Enron a "Buy," forecast 99 EPS of $[1.125] and a 13% five-year EPS growth rate for Enron and stated:

> Enron Corp The Comeback Kid
>
> - ENE has risen 11.3% this year: and has been the best performer among pipelines/energy conglomerates.
> - This is a very good company, which has had to make near term investing compromises in order to deliver on its long term agenda.

74. On 3/31/98, Enron filed its 97 Form 10-K with the SEC. This Form 10-K, signed by Lay, Causey, Fastow, Belfer, Blake, Chan, John Duncan, Foy, Gramm, Harrison, Jaedicke, LeMaistre, Meyer, Skilling, Urquhart, Wakeham, Walker and Winokur, included Enron's 97 financial statements which represented that Enron had long-term debt of only $6.2 billion, recurring net income of $515 million and net income of $105 million.

75. In fact, Enron has admitted that these results were materially misleading due to improper accounting for Chewco and JEDI and failure to make proposed audit adjustments. Enron has restated these results. Not restated, but equally egregious, was Enron's concealment of billions more in debt through the use of prepay contracts arranged by CitiGroup and JP Morgan.

76. On 4/15/98, Merrill Lynch issued a report on Enron, which rated Enron a "Buy," forecast 99 EPS of $[1.125] and a 13% five-year EPS growth rate for Enron and stated:

- ENE delivered a stronger quarter with the help of strong trading results.

* * *

ENE had a very good trading quarter.

77. On 4/16/98, CS First Boston issued a report on Enron, which rated Enron a "Buy," forecast 99 EPS of $[1.275] and a 15% five-year EPS growth rate for Enron and stated:

> The dramatic turn in electric wholesale earnings in the first quarter confirms our belief that Enron has achieved the critical mass necessary for sustained profitability. Enron's substantial investments in assets, people, systems, and capabilities were made well ahead of potential revenue generation. Having reached critical mass, Enron should now be able to rapidly increase revenues, profitability, and ROIC while maintaining a relatively fixed asset and expenditure base. Our expectation is for earnings growth to accelerate in 1998 as electric deregulation and retail access become a reality.

78. On 4/21/98, Enron filed a Registration Statement with the SEC registering shares of its common stock. It incorporated by reference Enron's 97 Form 10-K, Enron's financial statements for 97 and included Enron's results for the 1stQ 98. The Prospectus included Enron's results for the 1stQ 98, including revenues of $5.7 billion and net income of $214 million. These financial results were materially false and misleading in violation of GAAP as described herein. The Registration Statement was signed by Lay, Causey, Fastow, Belfer, Blake, Chan, John Duncan, Foy, Gramm, Harrison, Jaedicke, LeMaistre, Meyer, Skilling, Urquhart, Wakeham, Walker and Winokur. A Prospectus to sell 34.5 million of these shares at $25 was dated 5/5/98. The underwriters to the offering were CS First Boston, Lehman Brothers, Merrill Lynch, CIBC and JP Morgan. Enron used the proceeds of this securities issuance to pay down its short-term debt – either commercial paper or bank debt to JP Morgan and CitiGroup.

79. On 5/7/98, CIBC issued a report on Enron, which forecast 99 EPS of $[1.125] and stated:

> Enron remains well positioned in two of the most powerful global energy themes now under way: 1) the deregulation of wholesale and retail energy markets in developed economies and 2) the privatization of energy infrastructure in emerging economies. Accordingly, we continue to believe longer term earning power will build at attractive rates, and we would consider accumulating the shares on any

pullbacks near $[23.50-$24] or 19X projected 1999 EPS exclusive of Enron Retail Services.

80. On 7/7/98, Enron sold $250 million of 6.40% Notes due 7/15/06 and $250 million of 6.95% Notes due 7/15/28, with JP Morgan and Lehman Brothers acting as underwriters, via a Prospectus. Enron used the proceeds of this securities issuance to pay down its short-term debt – commercial paper and/or bank debt to JP Morgan and CitiGroup.

81. On 7/14/98, Enron announced its ***better-than-expected*** 2ndQ 98 results, stating:

> Enron Corp. announced today 1998 second quarter earnings of $[0.21] per diluted share, compared to $[0.19] ... in the second quarter of 1997. ***The strong results were led by growth in Enron's largest business, Wholesale Energy Operations and Services .... In addition, Enron Energy Services, the company's new retail business, continued to progress, executing a number of significant contracts with end-use customers for delivery of energy commodities and a full range of energy management services.***
>
> "***We are pleased to report another quarter of very solid earnings growth. These results confirm the operating strength of each Enron business unit and our ability to produce consistent, predictable earnings in spite of rapidly changing, highly volatile energy markets," said Kenneth L. Lay, Enron Corp. chairman and chief executive officer.... "[O]ur newer activities are firmly established, particularly the U.S. wholesale power marketing business and Enron Energy Services. Combined with a very substantial backlog of projects and opportunities, our business outlook is the strongest in the company's history.***"

Enron also reported that all nine of its major international power plant and pipeline projects ***continued to progress on schedule***, including its 826-MW power project in Dabhol, India, which was on schedule, 90% completed and would be in full commercial operation in 12/98.

82. On 7/14/98, CS First Boston issued a report on Enron, which rated Enron a "Buy," forecast 99 EPS of $[1.15] and a 15% five-year EPS growth rate for Enron and stated:

> Enron has clearly proven its ability to create value in the face of increasingly volatile gas and electric markets. The recent spike in power prices due to a La Nina heat wave sent most energy firms scrambling to cover positions, meet demand, and reorganize trading controls. However, Enron was able to capitalize on its broad risk management and trading capabilities and market experience, turning a volatile situation into a profitable one. Enron's tight position controls, superb credit controls, excellent delivery and logistic capabilities, and flawless back office procedures enabled ECT to generate about $60 million of its $101 million cash and physical profit from electric power marketing with zero credit exposure. ECT's long history with another notoriously volatile commodity, natural gas, is also a critical component of its current power marketing success.

* * *

We reiterate our Buy on Enron as it remains the best-positioned company to capitalize on further growth in wholesale gas marketing, wholesale electric marketing, and retail gas and electric marketing business lines, which we continue to believe hold huge profit potential. Based on the expected pace of electric unbundling as detailed in The E-D-Sing of Energy II, we believe that during the first quarter, Enron, with profitability now accelerating, passed the trough point in the electric power marketing profitability cycle.

83. On 7/14/98, CIBC issued a report on Enron which stated, "***Enron's longer-term growth prospects should remain strong.***"

84. On 7/15/98, Merrill Lynch issued a report on Enron, which rated Enron a "Buy, forecast 00 EPS of $1.26 and a 13% five-year EPS growth rate for Enron and stated:

- We look for a 98E-00E earnings profile of [$1.00-$1.125-$1.26]. EES should begin contributing nicely in 2000E.

Fundamental Highlights:

- ENE has considerably outperformed the market this year, and is being driven by both strong WEOS momentum and the EES story.

84.1 On 7/23/98, Salomon issued a report on Enron which stated:

Finance and Investing IBIT was $125 million vs. $38 million, up about 329%, which resulted from ENE's strong presence in the physical energy market that provides a unique platform to provide risk management and finance products to customers.

85. On 7/24/98, Enron announced the formation of a "***New Global Water Company***" and that it would purchase Wessex Water for $2.2 billion:

"The development, ownership and operation of water infrastructure is a logical extension of Enron's expertise developed in the worldwide energy business," said Kenneth L. Lay, Enron chairman and CEO. "***The proposed acquisition of Wessex represents an outstanding opportunity to build an international water business through a separate subsidiary. Wessex has a superior operational track record and a high-quality core management team that has been in place since the privatization of the industry in England and Wales in 1989. Those attributes, combined with our expertise in energy infrastructure project development, asset management, regulatory, finance and risk management services, will enable the new company to become a strong competitor in the global water industry.***

86. On 9/25/98, Enron issued a release regarding its new global water business named "Azurix," which stated:

Enron Corp. announced today the executive management team that will lead Azurix, the company's new global water business.

"***We have gathered top players from the water, gas and power industries who have proven track records in developing new businesses and growing existing***

> ***businesses domestically and abroad," said Rebecca P. Mark, chairman and CEO of Azurix. "All of these executives have exhibited strong leadership skills and have an unparalleled commitment to develop our international water business.***"

87. On 9/25/98, Enron, with Merrill Lynch and CitiGroup acting as underwriters, sold $250 million of floating rate notes due 3/30/00 via a Prospectus. Enron used the proceeds of that securities issuance to pay down its short-term debt – either commercial paper or bank debt to JP Morgan and CitiGroup.

88. On 10/13/98, Enron reported ***better-than-expected*** 3rdQ 98 results:

> Enron Corp. announced today 1998 third quarter earnings of $[0.235] per diluted share compared to $[0.23] ... in the third quarter of 1997. ***The results were led by continued growth in Wholesale Energy Operations and Services ....***
>
> "We are very pleased to report another quarter of strong results, generating $168 million of net income compared to $134 million a year ago. In a period of financial market uncertainty and commodity price volatility, ***Enron has demonstrated its ability to consistently generate solid and predictable earnings, as evidenced by the 60 percent increase in earnings in our Wholesale business,***" said Kenneth L. Lay, Enron Corp. chairman and chief executive officer.
>
> ... "***[P]rospects for future earnings growth continue to strengthen with the excellent progress of our new retail energy business," Lay said. "This quarter, Enron Energy Services signed contracts representing over $850 million of value, 70 percent over our plan.***"

89. On 10/13/98, Enron held a conference call for analysts and investors to discuss Enron's 3rdQ 98 results and its business. During the call, Skilling, Koenig, Causey and Fastow stated:

- ***Enron's news was extremely good. Enron had another excellent quarter.***
- ***Everything was going great with Enron. On a very positive note, Enron hedged its investment portfolio and its hedges in the investment portfolio performed extremely well even in uncertain financial markets. Really good news in the finance and investing component. Enron could not state how strong the wholesale business was.***
- ***Enron had a great quarter in the wholesale business. Enron was setting up for a great fourth quarter and a great 99 in the wholesale business.***
- ***Throughout 98, Enron's management disciplines were effective. This clearly differentiates Enron from its competitors.***
- ***Enron made significant strides in building both the skills and execution capabilities of EES, its new retail business. EES is very well positioned to capitalize on the unique opportunity in the retail commodity and services market. Enron was poised for long-term success in this business. Everything was on track in retail energy services. EES was looking very, very strong.***

- ***EES also continued to significantly expand its contracting activities. It was a very, very strong quarter for EES. EES would be profitable by the 4thQ 99.***

- ***Enron just had a great, great quarter in this segment. Over all, the third quarter was a very strong quarter for Enron. Strong earnings, very clean earnings for the quarter and Enron was feeling really good about how the year is coming and how 99 is setting up.***

90. Each of the statements made between 9/12/97-10/13/98 were false or misleading when issued. The true but concealed facts were:

(a) Enron's financial statements and results issued during this period were false and misleading as they inflated Enron's revenues and earnings to conceal billions of dollars of debt that should have been shown on Enron's balance sheet, as described in ¶¶106-168.

(b) Enron's financial condition, including its liquidity and credit standing, was not nearly as strong as represented, as Enron was concealing billions of dollars of debt that should have been reported on its balance sheet – and which would have very negatively affected its credit rating, financial condition and liquidity – by improperly transferring that debt to the balance sheets of various non-qualifying SPEs and partnerships it secretly controlled, as detailed herein.

(c) The results of Enron's wholesale (WEOS) business – its largest business unit – were manipulated and falsified to boost its reported profitability in various ways. ***First***, by phony or illusory hedging transactions with entities that were not independent of Enron. ***Second***, by the abuse of mark-to-market accounting by adopting unreasonable contract valuations and economic assumptions when contracts were initially entered into. And ***third***, by arbitrarily adjusting those values upward at quarter's end to boost the wholesale operation's profits for that period – a practice known inside Enron as "moving the curve." And Enron had not effectively hedged its WEOS merchant investment portfolio as most of the purported hedges were with non-independent parties in transactions structured such that the hedge depended on Enron stock and thus Enron was still at risk.

(d) Under Mark-Jusbasche, Enron International repeatedly deferred capital expenditures, including developer, financing and promotional fees, that were incurred on failed project proposals. For more than five years – between 93 and 97 – these deferred expenses were accumulated – a practice known inside Enron as "***snowballing***" – and very few write-offs were taken.

sheet was grossly inflated, which, in turn, inflated Enron's assets and distorted its apparent creditworthiness. In addition, Enron knew from discussions with government officials in India that they would oppose paying Enron for power from Dabhol at anywhere near the rates Enron intended to charge and, in fact, was charging after the plant began commercial operations. Dabhol would not be a strong contributor to earnings and profit.

Subsequent Disclosures

91. On 10/16/01, in reporting its 3rdQ 01 results, ***Enron revealed a $1 billion charge – a $1.11 per share charge – resulting in a $618 million or $.84 per share loss***. According to Enron, the $1 billion charge was due to and consisted of:

> – $287 million related to asset impairments recorded by Azurix Corp. These impairments primarily reflect Azurix's planned disposition of its North American and certain South American service-related businesses;
>
> – $180 million associated with the restructuring of Broadband Services, including severance costs, loss on the sale of inventory and an impairment to reflect the reduced value of Enron's content services business; and
>
> – $544 million related to losses associated with certain investments, principally Enron's interest in The New Power Company, broadband and technology investments, and early termination during the third quarter of certain structured finance arrangements with a previously disclosed entity.

92. A few weeks later, Enron revealed that it was restating its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below:

ENRON ACCOUNTING RESTATEMENTS

	1997	1998	1999	2000
Recurring Net Income Amount of Overstatement	$ 96,000,000	$113,000,000	$250,000,000	$ 132,000,000
Debt Amount of Understatement	$711,000,000	$561,000,000	$685,000,000	$ 628,000,000
Shareholders Equity Amount of Overstatement	$313,000,000	$448,000,000	$833,000,000	$1,208,000,000

93. The partnerships, including Chewco – ***were used by Enron management to enter into transactions that it could not, or would not, do with unrelated commercial entities***. Many of the most significant transactions were designed to ***accomplish favorable financial results, i.e., not to achieve bona fide economic objectives or to transfer risk***. Other transactions were implemented improperly ***to offset losses***. They allowed Enron to conceal from the market ***very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged – that is, that a third party was obligated to pay Enron the amount of those losses – when in fact that third party was simply an entity in which only Enron had a substantial economic stake. These transactions resulted in Enron reporting earnings from the 3rdQ 00 through the 3rdQ 01 that were almost $1 billion higher than should have been reported***!

94. As huge as the 11/01 restatements of Enron's 97-00 financial statements were, they just scratched the surface of the true extent of the prior falsification of Enron's financial statements, failing to eliminate additional hundreds of millions of dollars of phony profits as Enron, Andersen, Vinson & Elkins and the banks were still trying to keep Enron afloat and trying to conceal how extensive the fraud had really been.

95. By 11/28/01, the charade could be continued no longer and Enron's publicly traded debt had been downgraded to "junk" status by the rating agencies and on 12/2/01, Enron filed for bankruptcy – at the time ***the largest bankruptcy in history***. Enron's common and preferred stock have become virtually worthless and its publicly traded debt securities have suffered massive price declines, inflicting billions of dollars of losses on purchasers of those securities.

96. As outrage over what is likely the worst financial scandal involving a public company in the history of the United States erupted, Congress launched the most massive investigation it has ever undertaken of a public company's financial fraud, summoning before it some of the Enron executives and Andersen partners who were intimately involved in these matters. Defendants Lay, Fastow, Buy and Causey of Enron and David Duncan, the Andersen partner in charge of the Enron account, and Temple, a senior Andersen lawyer who directed the destruction of documents, ***have all refused to testify, asserting that their testimony would incriminate them.***

97. As detailed herein, the scheme to defraud Enron investors complained of was extraordinary in its scope, duration and size. Billions of dollars in phony profits were reported. Billions of dollars of debt was hidden. Enron shareholders' equity was overstated by billions of dollars. This was accomplished over a multi-year period through numerous manipulative devices and contrivances and misrepresentations to investors in Enron releases and SEC filings, including Registration Statements utilized to raise billions of dollars of new capital which was indispensable to keep Enron afloat. This fraudulent scheme could not have been and was not perpetrated only by Enron and its insiders. It was designed and/or perpetrated only via the active and knowing participation of Enron's general counsel, Vinson & Elkins, Enron's accounting firm, Andersen, and Enron's banks, including JP Morgan, CitiGroup, CS First Boston, Merrill Lynch, Deutsche Bank, Barclays, Lehman Brothers, CIBC and Bank America. Each of these actors directly violated the securities laws and played an important role in the fraudulent scheme and wrongful course of business complained of herein.

DEFENDANTS' SCHEME AND FRAUDULENT COURSE OF BUSINESS

98. Each defendant is liable for (i) making false statements, or for failing to disclose adverse facts while selling Enron securities, and/or (ii) participating in a scheme to defraud and/or a course of business that operated as a fraud or deceit on purchasers of Enron's public securities during the Class Period (the "Wrongful Conduct"). This Wrongful Conduct enabled the Enron Defendants to sell or dispose of more than 227,000 shares of Enron stock at artificially inflated prices for more than $5 million in illegal insider trading proceeds. The Wrongful Conduct also allowed Enron's accountants, law firm and banks to pocket hundreds of millions of dollars in fees, commissions and other charges as detailed herein.

ENRON DEFENDANTS' SCIENTER ALLEGATIONS

99. As pleaded in this Complaint, the financial fraud and fraudulent course of business at Enron permeated virtually all aspects of Enron's operations. In addition, the fraud was not only widespread throughout Enron but involved the frequent manipulation of Enron's public disclosures and financial reports via ***huge*** transactions – many of which were entered into at or near the end of

reporting periods, a circumstance, especially when it is repeated quarter after quarter as it was at Enron, which is a significant red flag. Further, not only were these transactions large, frequent, widespread and often at quarter-end, they were also highly structured and complex, requiring the personal attention of several top executives of Enron, especially those sitting on the Enron Management Committee, and the review and approval of board members, especially those sitting on the Enron Board's Executive, Finance and Audit Committees, which had direct jurisdiction over these types of corporate transactions and activities. Thus, it is logical, if not obvious, that all of Enron's officers and directors knew of, or at a minimum acted in reckless disregard of, the falsification of Enron's financial reports and the other false and misleading statements being made about its business operations.

100. In addition, every Enron Defendant sued for fraud had a strong motive to engage and participate in the scheme to defraud and to conduct Enron's business in a manner that operated as a fraud or deceit on purchasers of Enron's publicly traded securities. Every Enron Defendant sued for fraudulent misconduct sold substantial amounts, either in absolute or relative terms, of his or her Enron stock, pocketing significant proceeds from his or her illegal insider trading. In addition, Enron's officers were in a position to also pocket huge cash bonuses if, but only if, Enron achieved certain preset earnings targets and its stock advanced to certain targeted trading levels. Also, the Enron Defendants had permitted Enron's business model to evolve to where the actual ongoing success of the finances of the business depended upon keeping Enron's stock price trading above several equity issuance trigger levels which placed further pressures on them to do whatever was necessary to keep Enron's stock trading at high levels.

101. The Enron Defendants who were on Enron's Management Committee were the top executives of Enron. They had daily contact with each other while running Enron as "hands-on" managers, dealing with the important issues facing Enron's business, its JEDI partnerships and the related SPEs and Enron's future revenues and profits. The Enron Defendants controlled and/or possessed the power and authority to control the contents of Enron's Registration Statements, its Form 10-K SEC filings and its quarterly and annual reports and press releases, and were provided with copies of the filings, reports and releases alleged herein to be misleading prior to or shortly after

their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected.

102. The Enron directors who were on Enron's Executive, Finance and Audit Committees were much more involved in Enron's day-to-day operations than is normally the case with "outside directors." These directors were also in frequent contact with Lay, Skilling, Fastow, Buy and Causey to receive information from them about Enron's business and they received copies of Enron's internal operating and budget reports circulated to Enron's top executives. The Enron securities offerings during the Class Period ***could not have taken place without the authorization of Enron's Board.***

103. Because of the Enron Defendants' positions with the Company, they each had access to the adverse non-public information about its business, partnerships and investments, finances, products, markets and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management and/or Board of Directors meetings and committees thereof and via reports and other information provided to them in connection therewith.

104. As alleged herein, the Enron Defendants acted with scienter in that they knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading, that such statements or documents would be issued or disseminated to the investing public, and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, the Enron Defendants, by virtue of their receipt of information reflecting the true facts regarding Enron, their control over, and/or receipt and/or modification of Enron's allegedly materially misleading misstatements and/or their association with the Company which made them privy to confidential proprietary information concerning Enron, participated in the fraudulent scheme alleged herein.

105. The scienter of the Enron Defendants sued for fraud is further evidenced by the amount of insider selling. The Enron insiders sold the following amounts of stock:

Enron Corp.
Summary of Class Period Insider Sales
(all share amounts are adjusted for the
Company's 8/13/99 2-for-1 stock split)

INSIDER	SHARES SOLD	PROCEEDS
Belfer	7,360	$195,040
Fastow	24,930	$657,529
Gramm	7,760	$191,090
Harrison	41,800	$1,076,350
Horton	49,980	$1,137,045
Mark-Jusbasche	83,072	$2,077,487
Sutton	12,600	$340,400
TOTAL:	227,502	$5,674,941

ENRON'S FALSE FINANCIAL STATEMENTS

106. In order to overstate Enron's assets, shareholders' equity, revenues, net income and earnings per share, understate debt, and present materially misleading financial statements during the Class Period, the defendants caused the Company to violate GAAP and SEC rules, in several ways, including:

(a) by improperly characterizing loans as forward contracts in order to conceal the true amount of Enron's debt;

(b) by improperly failing to consolidate entities into Enron's financial statements, defendants hid hundreds of millions in losses that should have properly reduced Enron's earnings, and hid hundreds of millions in debt which should have been included on Enron's balance sheets reported during the Class Period;

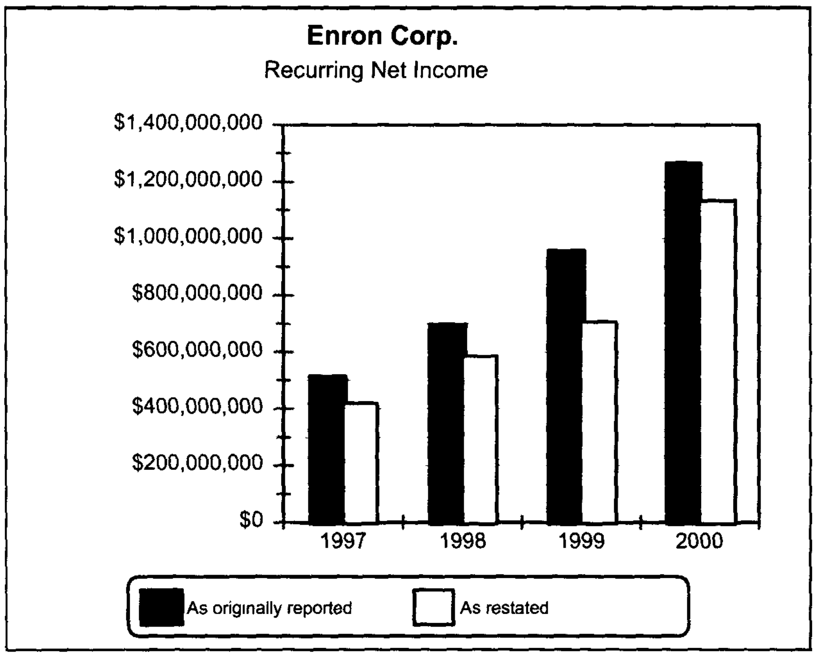
(c) by grossly abusing mark-to-market accounting;

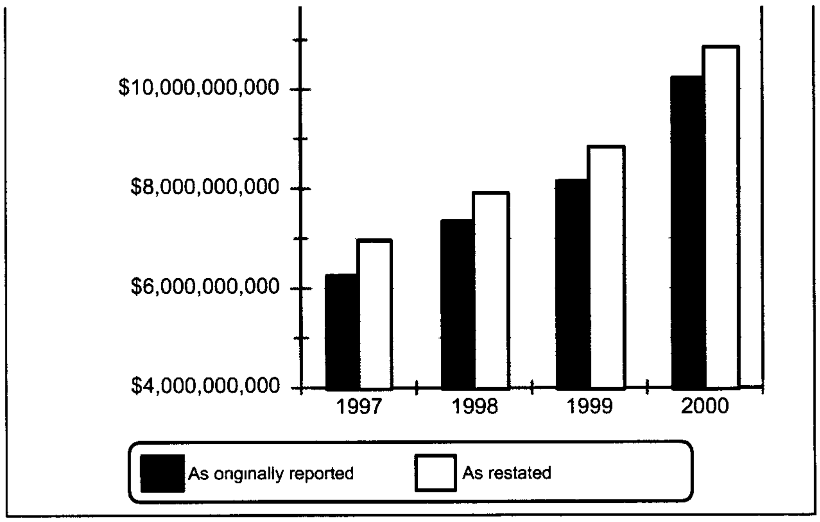
(d) by improperly accounting for long-term contracts;

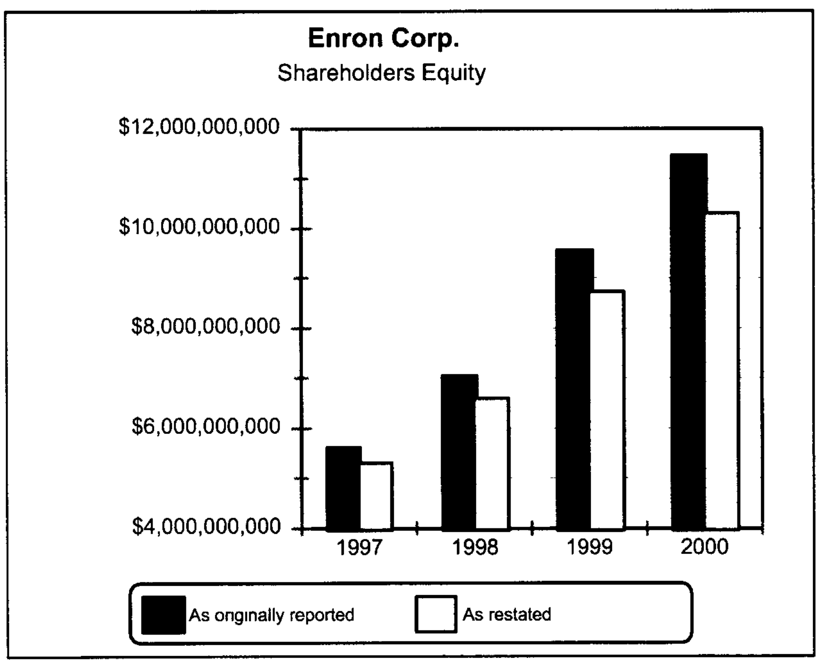
(e) by failing to record required write-downs for impairment in the value of Enron's investments, Enron's long-term assets and its technology investments on a timely basis; and

(f) by not recording $57 million in proposed audit adjustments for 97.

107. Enron has now admitted that its 97 through 00 year-end and 97 through 01 interim quarterly financial statements as originally filed with the SEC were false and improperly reported and has restated the results. While Enron's improper accounting was much more widespread than what the Company has either admitted or restated as alleged below, the scope and size of the restatement is substantial:







108. Enron's manipulation of its results also had a dramatic impact on its key "debt-to-equity" ratio, measured as debt to total capitalization. Even the restatement, which did not correct

the impact of Enron's phony forward sales contracts alleged herein, shows a significant impact from the concealed debt and improper equity adjustments on the Company's debt-to-equity ratio.

109. The restatement adversely affected these debt and earnings ratios significantly:

	1997	1998
Debt to Equity		
As reported	44.6%	41.9%
As restated	48.3%	44.8%
Ratio of Earnings to Fixed Charges		
As reported	1.02	2.08
As restated	.88	1.94

110. The amount of the restatement, however, was just the tip of the iceberg. The Enron Defendants engaged in many other egregious manipulations of Enron's financial statements which were not part of the restatement. As Accounting Malpractice.com noted on 2/22/02:

> Each passing week raises a new concern about not only the original financial reporting but also the veracity of the restatement itself. The emerging question is not whether a more conservative restatement would have reflected smaller profits, but whether a proper restatement would have reflected ***any profits*** from 1997 and forward?

111. In fact, Enron's restatement did not correct the Company's abuse of mark-to-market accounting, which accelerated or fabricated profits, including for its broadband business. The Company, with the assistance of certain of the banking defendants, also engaged in false forward sales contracts (prepays) which concealed hundreds of millions of dollars in loans, none of which are part of the restatement. Had Enron properly reported its results, its broadband efforts would have been shown to be a complete failure and its debt-to-equity ratios would have been much worse than even the restated amounts.

112. During the Class Period, Enron painted a false picture of profitability and liquidity. This included the amounts reported on the Company's financial statements. Enron reported the following financial results for 97-98:

	1997	1998
Revenues	$20.3B	$31.2B
Recurring Net Income	$515 M	$698 M
Net Income	$105M	$703M

EPS	$0.16	$1.00
Total Assets	$22.5 B	$29.4B
Debt	$6.25 B	$7.36B
Shareholders' Equity	$5.62 B	$7.05B
Ratio of Earnings Fixed Charges	1.02	2.08
Debt to Equity[3]	44.6%	41.9%

113. Enron included these results in press releases and SEC filings, including Form 10-Qs for the interim results and Form 10-Ks for the annual results. The financial results were also included and/or incorporated by reference into Enron's many Registration Statements and Prospectuses filed during the Class Period pursuant to debt and equity offerings. The SEC filings represented that the financial information was a fair presentation of Enron's financial results and financial position and that the results were presented in accordance with GAAP.

114. These representations were false and misleading as to the financial information reported, as such financial information was not prepared in conformity with GAAP, and was not "a fair presentation" of the Company's operations and financial position due to: (i) the Company's improper accounting for its subsidiaries; (ii) its abusive and manipulative use of mark-to-market accounting; (iii) its mischaracterization of loans as forward sales contracts; (iv) its failure to record losses for impaired assets; and (v) its false and inadequate disclosures about its transactions with related parties. These manipulations, among others, caused the financial results to be presented in violation of GAAP and SEC rules.

115. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate. Regulation S-X requires that interim financial statements must also comply with GAAP, with the

[3] Debt to equity is calculated using total capitalization as the denominator, consistent with what Enron reported in its Form 10-Ks.

exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying the annual financial statements most recently filed. 17 C.F.R. §210.10-01(a).

116. Moreover, pursuant to §13(b)(2) of the 1934 Act, Enron was required to "(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that – (i) transactions are executed in accordance with management's general or specific authorization; [and] (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles."

A. Prepay Transactions with Banks

117. The Enron Defendants also engaged in deceptive transactions with certain banking defendants to disguise loans to the Company as hedging or derivative transactions.

118. This has come to light in Congressional testimony:

> The evidence also indicates that some of these financial institutions knowingly allowed investors to rely on Enron financial statements that they knew or should have known were misleading.
>
> Our investigation, among other things, focused on one financing vehicle known as "prepay." A prepay is commonly thought of as an arrangement in which one party pays in advance for a service or product to be delivered at a later date. Companies use prepays to receive money up front for services to be rendered in the future.
>
> * * *
>
> Enron used these so-called "prepay" transactions to obtain more than $8 billion in financing over approximately 6 years, including $3.7 billion from 12 transactions with Chase and $4.8 billion from 14 transactions with Citigroup. This $8 billion figure is a conservative estimate for the 6 year period, based on the documents we were able to review; the full amount since Enron began using prepays in 1992 may be much larger. Barclays, Credit Suisse First Boston, FleetBoston, Royal Bank of Scotland, and Toronto Dominion participate in over $1 billion of the prepay transactions. Accounting for "prepay" proceeds as cash flow from operations, rather than cash from financing gave the impression that the money from the prepays was part of Enron's ordinary business activities and not debt.
>
> Moreover, the Subcommittee has learned that Enron was simultaneously treating the prepay transactions as loans on its tax returns in order to claim the interest expense as a business deduction. Enron's practice of using prepay transactions to understate debt and overstate cash flow from operations made its

> financial statement look much stronger. That, in turn, helped Enron maintain its investment grade credit rating and support, even boost, its share price.
>
> * * *
>
> Internal communications show that it was common knowledge among Enron, Chase and Citigroup employees that the "prepays" were designed to achieve accounting, not business, objectives and that Enron was booking the "prepay" proceeds as trading activity rather than debt. The evidence indicates that Chase and Citigroup not only understood Enron's accounting goal - increasing operating cash flow without reporting debt - but designed and implemented the financial structures to help Enron achieve its objective. Moreover, they accepted and followed Enron's desire to keep the nature of these transactions confidential.
>
> ... Despite its desire to keep the information confidential, Enron dealt with so many financial institutions that word of its "prepay" structures began to circulate. Chase developed a "pitch book" to sell other companies on Enron-style prepays. The presentation describes the transactions as "Balance sheet 'friendly.'" It also sets out in general terms Chase's use of its special purpose entity, Mahonia, in structuring the trades and clearly explains that the trades are orchestrated to work together. This explanation of the deliberate packaging of the trades flatly contradicts claims that the trades are independent and unrelated. Chase apparently entered into Enron-style prepays with seven companies apart from Enron.
>
> Citigroup also developed a presentation to sell companies on Enron-style prepays, promoting, in particular, the Yosemite structure it had developed to raise the money for the prepays from third party investors without explicitly informing them of the transactions. The presentation boasts that the structure "[e]xpands capability to raise non-debt financing ... improve cash flows from operations" and "[e]liminates the need for Capital Market disclosure, keeping structure mechanics private." Citigroup shopped this Enron-style prepay to 14 companies, successfully selling it to at least three.

119. Enron and JP Morgan used Mahonia, a Jersey company, and related companies to arrange approximately $2.2 billion of "back to back" transactions between 12/97 and 12/00. Specifically, Enron Natural Gas Marketing Corp. or Enron North America Corp., as sellers, entered into six separate agreements characterized as "forward sales contracts" that purported to provide for the delivery of crude oil and natural gas over a 4-to-5 year period (the "Forward Sales Contracts") with either Mahonia or Mahonia Gas (collectively "Mahonia"), as purchasers. In reality, these were loans to Enron disguised as hedging contracts.

120. The Forward Sales Contract was a sham. First, Enron never intended to deliver the subject crude oil and natural gas as evidenced by the fact that it did not enter into contracts with suppliers to "hedge" its obligations for delivery of the crude oil and natural gas required to be delivered under the terms of the forward sales contracts, which it would have done in the ordinary

course of business if actual deliveries of crude oil and natural gas had been contemplated. Second, Mahonia did not enter into contracts with third parties for the delivery of the oil and gas to be supplied by Enron under the terms of the Forward Sales Contracts, which contracts were secured by surety bonds, reflecting that it never in fact intended to take delivery of crude oil and natural gas from Enron. Third, Mahonia was not listed as a firm transportation customer of any of the pipelines at which the natural gas deliveries were to have been made under the Forward Sales Contracts relating to the delivery of the natural gas at the delivery points specified in such Forward Sales Contracts, notwithstanding its express representation and warranty that it had the capacity and intended to take delivery of the natural gas to be delivered under such Forward Sales Contracts and that it was acquiring such natural gas in the ordinary course of business.

121. Enron overstated revenues and earnings before taxes by recording contracts worth approximately $2.2 billion of "back to back" transactions between 12/97 and 12/00 by recording loans received from JP Morgan as forward sales contracts. As *The New York Times* noted on 2/19/02:

> The transaction records, many of which were held overseas and have never before been disclosed, indicate that many of the trades would not have involved any delivery of gas; experts said the pattern of trading suggested the purpose of the deals was to disguise bank loans.
>
> In all, Enron took advantage of accounting rules to avoid reporting as much as $3.9 billion in loans on its balance sheet in the decade before its collapse last fall, thus improving its financial picture in the eyes of credit rating agencies and Wall Street.

¶¶122-125 deleted.

B. Enron's Failure to Consolidate Subsidiaries and SPEs

126. In order to maintain favorable credit ratings, *inter alia*, Enron management and its bankers developed a scheme to keep loans, obtained through partnerships and SPEs, off Enron's financial statements and at the same time inappropriately record income from transactions with these SPEs. Enron entered into arrangements with affiliates that Enron controlled and Enron financed. In violation of GAAP, Enron failed to consolidate the entities into its financial statements.

127. GAAP, as set forth in Accounting Research Bulletin ("ARB") No. 51, ¶1, states in part:

> There is a ***presumption that consolidated statements are more meaningful*** than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group ***directly or indirectly has a controlling financial interest in the other companies.***

128. FASB Statement of Financial Accounting Standards ("SFAS") No. 94, ***requires*** consolidation of all majority-owned subsidiaries ***unless*** control is temporary or ***does not rest with the majority owner.***

129. GAAP also provides that, under very limited circumstances, certain qualifying SPEs do not have to be consolidated. But in order to even qualify as an SPE, and in turn, avoid consolidation, a public company's investment entity must meet very specific criteria under SFAS No. 125. For example, the SPE must have standing apart from the transferor (Enron) and the transferor cannot maintain effective control over the transferred assets. SFAS No. 125, ¶¶9c, 26.

130. Thus, in accordance with GAAP, to the extent an Enron investment entity was even qualified as an SPE, a party unrelated to Enron had to be independent, had to control the SPE and must have maintained the risks and rewards of ownership. The defendants knew however, that for many of Enron's SPEs, it directly or indirectly maintained control over the SPE, and knew that such entities did not qualify as SPEs under SFAS No. 125. In order to improperly keep these entities off Enron's books, the Enron Defendants focused on language from FASB Emerging Issues Task Force Abstracts ("EITF") No. 90-15 regarding leasing transactions. Here, consolidation could be avoided if the initial substantive residual equity investment, on behalf of the lessor, was at least 3%.[4]

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[4] Although not applicable to the transactions alleged herein, additional guidance for SPEs is described in EITF. The EITF guidance which the Enron Defendants relied on as to whether an SPE should be consolidated was derived from EITF Issue No. 90-15, Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions; EITF Topic No. D-14, Transactions Involving Special-Purpose Entities; and EITF Issue No. 96-21, Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entitles. Furthermore, EITF Topic No. D-14 provides the general guidance for non-consolidation of an SPE:

> Generally, the SEC staff believes that for ***nonconsolidation*** and sales recognition by the sponsor or transferor to be appropriate, the majority owner (or owners) of the SPE ***must be an independent third party who has made a substantive capital investment in the SPE, has control of the SPE, and has substantive risks and rewards of ownership of the assets of the SPE*** (including residuals). Conversely, the SEC staff

Notwithstanding that EITF No. 90-15 states that a greater percentage might well be necessary depending on circumstances and that this standard regarding leased assets did not even apply to the SPEs Enron had created, the financial management of Enron, with the participation of Andersen, Enron's lawyers and the bank defendants, inappropriately used this provision as the overriding rule to avoid consolidating certain SPEs. Moreover, many of Enron's SPEs did not even meet the 3% minimum standard. Accordingly, these SPEs, under any accounting machination, were improperly not consolidated or adequately disclosed in Enron's financial statements. As such, billions of dollars in loans and losses were concealed, and millions of dollars of income was improperly recognized from transactions with these entities, some of which were non-qualifying SPEs. The Company's use of SPEs to monetize (accelerate recognition of) future contract revenues and book them as current revenues was known internally as "Enron's trick."

131. Chewco Investments was an entity that should have been, but was not, consolidated. Chewco was less than 3% owned by parties independent to Enron. Consequently, Chewco was improperly excluded from Enron's financial statements despite being controlled by Enron. Chewco was formed in 97 with $400 million in financial backing to buy interests in another Enron partnership, and was run by Kopper, a managing director of Enron's Global Equity Markets Group. Neither this entity, nor its relationship to Enron, was disclosed in Enron's SEC filings during the Class Period.

132. More specifically, in 93, Enron created a joint venture investment partnership called JEDI. Enron was the general partner but, because Enron and its limited partner had joint control, Enron did not consolidate JEDI into its consolidated financial statements. In 97, Enron needed to replace the limited partner's interest in JEDI. In order to maintain JEDI as an unconsolidated entity, Enron needed to identify a new independent partner. Unable to find any independent entity willing to invest, in early 11/97, Fastow created a new entity to be the new limited partner, and named it

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believes that nonconsolidation and sales recognition are not appropriate by the sponsor or transferor when the majority owner of the SPE makes only a nominal capital investment, the activities of the SPE are virtually all on the sponsor's or transferor's behalf, and the substantive risks and rewards of the assets or the debt of the SPE rest directly or indirectly with the sponsor or transferor.

"Chewco Investments" – after the Star Wars character "Chewbacca." Kopper, an Enron employee who reported to Fastow, was inserted as manager of Chewco, because, as Vinson & Elkins advised, since Kopper was not a senior officer of Enron, his role in Chewco would not have to be disclosed. Vinson & Elkins prepared the legal documentation for these entities.

133. Enron also put together a bridge financing arrangement, under which Chewco and its members would borrow $383 million from two banks on an unsecured basis to buy out the limited partner's interest from JEDI. The loans were guaranteed by Enron. However, the transaction did not comply with SPE non-consolidation rules since Kopper, an Enron employee, controlled Chewco, and Chewco had no third-party independent investors. In order to qualify for non-consolidation, Enron sought to replace the bridge financing with another structure that would qualify Chewco as an SPE with sufficient outside independent equity such that the consolidation of Chewco and JEDI into Enron's financial statements could be avoided at year end 97.

134. To achieve this goal, in 12/97, Enron created a new capital structure for Chewco, consisting of: (a) a $240 million unsecured subordinated loan to Chewco from Barclays, which Enron guaranteed; (b) a $132 million advance from JEDI to Chewco under a revolving credit agreement; and (c) $11.5 million in equity (representing 3% of total capital) from Chewco's general and limited partners. On 12/18/97, Kopper transferred his ownership interest in Chewco to William Dodson, Kopper's domestic partner. This sham transfer to Dodson was made for the sole purpose of creating the false impression that Kopper, and thus Enron, had no formal interest in Chewco.

135. However, even after employing the bogus transfer to Dodson, the Enron Defendants could not get the 3% equity needed to avoid consolidation because Kopper indirectly invested approximately $125,000 in Chewco before transferring his interest to Dodson. However, no third-party investors were willing to provide outside equity. To obtain the remaining $11.4 million needed to reach 3%, Barclays agreed to provide what were described as "equity loans" to entities investing in Chewco. Barclays and the Enron Defendants prepared the documentation to allow Barclays to characterize the advances as loans (for business and regulatory reasons), while allowing Enron and Chewco simultaneously to mischaracterize them as equity contributions in order to approach the 3% equity investment. The Barclays loans were reflected in documents that resembled promissory notes

and loan agreements, but were labeled "certificates" and "funding agreements." The Barclays documents required the borrowers to pay "yield" at a specified percentage rate, *i.e.*, interest. Barclays, however, threw a wrench into the scheme by requiring the borrowers to establish cash "reserve accounts" of $6.6 million in cash that would secure repayment of the $11.4 million. The reserve account was funded when JEDI wired $6.58 million to Barclays on 12/30/97. The agreement was prepared by Vinson & Elkins. This transfer cut Chewco's purported 3% at-risk, independent "equity" in half.

136. The problems with the purported independent "equity" in Chewco were known and openly discussed within Enron. Barclays clearly knew about the manipulation since it helped structure the $11.4 million loan to appear as equity, and Vinson & Elkins knew due to its involvement in setting up the paperwork for the transaction.

137. Enron has now admitted that Chewco and JEDI did not meet the criteria to qualify as unconsolidated SPEs and has restated its results to consolidate these entities' losses and debt into its own financial statements. As a result, Enron failed to record losses from and debt attributed to these two entities by the following amounts:

	1997	1998
Unrecorded Losses	$45M	$107M
Unrecorded Debt	$711M	$561M

C. Enron's Failure to Make Proposed Audit Adjustments and Reclassifications

138. Enron has also admitted to failing to make proposed audit adjustments and reclassifications it was informed about by Andersen in prior years because it had considered those adjustments "immaterial." In each year, the changes which Enron refused to make would have reduced Enron's net income. Enron has admitted that the proposed adjustment for 97 was $51 million. This represented 48% of net income and 10% of recurring net income. Yet Enron

considered this amount to be "immaterial." However, Enron was required to consider the materiality of events in the aggregate. SEC Staff Accounting Bulletin ("SAB") No. 99 states:[5]

> Even though a misstatement of an individual amount may not cause the financial statements taken as a whole to be materially misstated, it may nonetheless, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading. Registrants and the auditors of their financial statements accordingly should consider the effect of the misstatement on subtotals or totals. The auditor should aggregate all misstatements that affect each subtotal or total and consider whether the misstatements in the aggregate affect the subtotal or total in a way that causes the registrant's financial statements taken as a whole to be materially misleading.

D. Enron's Restatement Is an Admission the Prior Financial Statements Were Materially False

139. The fact that Enron has restated its financial statements for 97 through the 2ndQ 01 is an admission that the financial statements originally issued were false and that the overstatement of revenues and income was material. Pursuant to GAAP, as set forth in APB No. 20, the type of restatement announced by Enron was to correct for material errors in its previously issued financial statements. *See* APB No. 20, ¶¶7-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change as it dilutes confidence by investors in the financial statements, it makes it difficult to compare financial statements and it is often difficult, if not impossible, to generate the numbers when restatement occurs. *See* APB No. 20, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances, *i.e.*, when there is a change in the reporting entity, there is a change in accounting principles used or to correct an error in previously issued financial statements. Enron's restatement was not due to a change in reporting entity or a change in accounting principles, but rather, to misstatements in previously issued financial statements. Thus, the restatement is an admission by Enron that its previously issued financial results and its public statements regarding those results were false and misleading.

140. The restatement of certain issues described above was, however, just the tip of the iceberg. Enron engaged in many other egregious manipulations which were not part of the restatement. As Accounting Malpractice.com noted on 2/22/02:

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[5] Even though SAB No. 99 was issued in 8/99, after the time Enron and Andersen made these decisions, SAB No. 99 expressed that it did not create new GAAP, but instead reemphasized existing GAAP.

> Each passing week raises a new concern about not only the original financial reporting but also the veracity of the restatement itself. The emerging question is not whether a more conservative restatement would have reflected smaller profits, but whether a proper restatement would have reflected any profits from 1997 and forward?

E. Enron's Abuse of Mark-to-Market Accounting

141. To improperly and prematurely accelerate revenue recognition, Enron grossly abused mark-to-market accounting on many of its energy trading contracts and broadband transactions.

142. Under conventional accounting, energy companies record revenue from long-term contracts as the revenue is earned over the contract period. Under mark-to-market accounting however, in certain specified circumstances, revenue to be received under a long-term contract (discounted to present value) may all be recognized up front. Pursuant to GAAP, as set forth in EITF No. 98-10, Accounting for Contracts Involved in Energy Trading Risk Management Activities, a non-derivative energy trading contract is "mark-to-market" with gains and losses included in earnings and separately disclosed in the footnotes. Mark-to-market accounting was used by Enron to recognize the present value of a five-year contract as earnings in a single quarter. Mark-to-market accounting is allowed only where contract revenue streams are predictable and based on historical records of similar transactions. However, the Enron Defendants knew there was no historical track record for many of the transactions to which Enron applied mark-to-market accounting.

143. For example, Enron improperly stretched mark-to-market past the limit by inappropriately applying it to transactions like broadband transactions and its retail/commercial energy demand-side management ("DSM") contracts. DSM contracts bundled various energy-related products and services to customers, including providing power and equipment commodities, and management and consulting services related to a customer's usage of power. While mark-to-market accounting is appropriate under certain circumstances for long-term contracts where the resulting revenue over time is predictable based on a historical record of similar transactions, as in straight commodity transactions such as oil and gas, it was not appropriate for Enron's DSM and broadband contracts. Mark-to-market accounting was inappropriate as no historical track record existed for these deals from which the Company could determine how much of the contract revenue was likely to be recovered over the life of the contract, and the contracts were highly speculative, with

indeterminate outcomes. Accordingly, it was unreasonable to book significant amounts of the revenue up-front rather than over time. Additionally, mark-to-market accounting of Enron's DSM contracts was improper because most of the expected revenues were attributable to long-term services to be provided by Enron (normally booked over time, using the accrual accounting method), with only a small portion attributable to the commodity components for which mark-to-market rules could potentially apply.

144. Because the use of mark-to-market accounting requires the ability to make reasonable estimates of future income streams, longer term contracts such as Enron's introduced more uncertainty into the estimate. The Enron Defendants improperly took full advantage of the fact that contracts that exceed four years could result in a wide range of fair value estimates and thus provide Enron with wide leeway in estimating the value of the contract. The Enron Defendants recorded income from these contracts even though they realized that once the contracts began to be performed, many would become losses because the cost, price and other assumptions were never valid to begin with. To avoid recording losses when it started to look like a deal was about to unfold, Enron would shift the curves – changed the estimate – to compensate for the anticipated loss, further misleading the shareholders. A former employee noted, "shifting the curve and making new deals to bury the losses from the past is constantly the strategy." Another former trader stated: "It was very simple. You just tweaked the assumptions on different variables, which were changed to make the return higher."

145. When Enron employed mark-to-market accounting, the Company calculated a range of revenue and risk possibilities (*i.e.*, a low revenue/low risk model, or a high revenue/high risk model). Enron consistently chose the high revenue/high risk model for nearly every deal, but because Enron moved debt, costs, losses and liabilities off its balance sheet through SPEs, this accumulation of risk was not disclosed to investors.

F. Enron Violated GAAP in Accounting for Long-Term Construction Contracts

146. Enron used non-recourse debt to finance a wide array of its plant building projects over the years. By using non-recourse debt, Enron relied on a variety of contracts with an assortment

of third parties, as well as the tax benefits of the underlying assets, to establish a reliable cash flow that would support the financing. These contracts, rather than the general credit of Enron and other owners, provided the credit for the financing. In fact, the lenders typically agreed not to seek repayment of the debt by Enron and the other owners, who would have no liabilities except to the extent of any obligations Enron and the owners undertook pursuant to any project contracts, such as operating agreements and throughput contracts. Enron, as the owner of the project, could achieve off-balance-sheet (non-consolidation) accounting only if the debt was non-recourse to it and it owned 50% or less of voting control.

147. By accounting for these projects on a non-consolidated basis, Enron International, a subsidiary of Enron, could recognize as revenue, approximately 5% of contract value for construction services provided to Enron.

148. However, according to former employees, to inflate reported revenues, Enron International improperly recognized revenue in connection with many of these projects, by recognizing 10% of the construction services contract value as revenue upon signing. Some of the projects identified include, but are not limited to:

Project Name	Description	Contract Value	Date Started
Cuiaba Integrated Energy Project	A 480-megawatt, combined-cycle natural gas power plant in Cuiabá, Brazil.	$400 million	1998
Sarlux Power Project	A 551-megawatt Sarlux combined cycle gasification power plant on the island of Sardinia in the Mediterranean Sea.	$550 million	1997
Elektrocieplownia Nowa Sarzyna Project	A 116-megawatt power plant in southeastern Poland, a natural gas-fired, cogeneration plant.	$120 million	1998
Enron Piti Power Project	Enron constructed an 80-megawatt baseload, slow-speed diesel plant in Piti, Guam under an Energy Conversion Agreement with the Guam Power Authority.	$110 million	First half of 1997

149. Enron International accounted for its long-term construction contracts under the percentage-of-completion method. The percentage-of-completion method recognizes income as

work progresses on the contract. The method is based on an estimate of the income earned to date, less income recognized in earlier periods. Estimates of the degree of completion usually are based on one of the following (*See* ARB No. 45, ¶4):

- The relationship of costs incurred to date to expected total costs for the contract.
- Other measures of progress toward completion, such as engineering estimates.

In addition, during the early stages of a contract, all or a portion of items such as material and subcontract costs may be excluded if it appears that the results would produce a more meaningful allocation of periodic income.

150. Enron's accounting for long-term construction projects was false and misleading, resulting in an overstatement of revenues and earnings during the Class Period. Indeed, recognizing 10% of the contract value as revenue at signing before any work had been completed was in direct violation of GAAP.

G. Enron's Improper Snowballing of Costs on Unsuccessful Bids

151. During 97 and 98, Enron improperly capitalized, rather than expensed, costs associated with unsuccessful bids for projects. The project bid costs were then improperly included in bid costs for future projects. These capitalized costs were ultimately written off in the 1stQ 99, but to cloak the true nature of the writedown, the writedown was attributed to a "change in accounting."

152. Enron International repeatedly deferred capital expenditures, including developer, financing and promotional fees, that were incurred on failed project proposals. Former directors and vice presidents watched for more than five years – between 93 and 97 – while these deferred expenses were accumulated – a practice known company-wide by accounting and finance personnel as "snowballing" – and very few write-offs were taken. Costs for South African projects involving oil and gas reserves, pipelines, and a plant designed to convert ore into another form of energy, and projects in China, among others, were snowballed quickly– the cash burn rate was as much as ***one million dollars a month***. Quarter after quarter, year after year, Enron International "got pressure from corporate about meeting earnings," which made even a hint about write-downs – even when

it was clear that the proposed project would never go forward – very unpopular at the end of a reporting period. Consequently, the snowball grew exponentially – so large that an international accounting officer told Enron CAO Causey that a writedown had to be taken because so many proposals were no longer even arguably viable. However, Causey, at Skilling's direction, responded that "corporate didn't have room" to take a writedown. By 97, years past when start-up and proposal costs should have been written off, Enron had deferred a $100-million snowball on some 75 projects, including those in Central and South America, and the Dabhol power plant in India while the cash-burn rate – virtually all deferred – dwarfed the revenue return. In fact, internal Enron accountants knew the practice was improper and were worried about doing it.

H. Enron's Improper Accounting for Long-term Assets and Investments

153. During the Class Period, Enron also falsified its financial statements by failing to record losses for the impairment of certain of its long-term assets and investments, including its long-term construction projects.

154. GAAP, as set forth in SFAS No. 121, requires that companies review long-lived assets to determine if the assets are impaired. SFAS No. 121, ¶¶5-6:

> 5. The following are examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed:
>
> a. A significant decrease in the market value of an asset
>
> b. A significant change in the extent or manner in which an asset is used or a significant physical change in an asset
>
> c. A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator
>
> d. An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset
>
> e. A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue.
>
> 6. If the examples of events or changes in circumstances set forth in paragraph 5 are present or if other events or changes in circumstances indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, the entity shall estimate the future cash flows expected to result from the

use of the asset and its eventual disposition. Future cash flows are the future cash inflows expected to be generated by an asset less the future cash outflows expected to be necessary to obtain those inflows. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the entity shall recognize an impairment loss in accordance with this Statement. Otherwise, an impairment loss shall not be recognized; however, a review of depreciation policies may be appropriate.

(Footnote omitted.)

155. GAAP, as set forth in SFAS No. 115, requires that a loss be recorded for impairment in investments when the impairment is other than temporary. SFAS No. 115, ¶16, states in part:

> For individual securities classified as either available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. For example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss).

156. During the Class Period, contrary to GAAP, Enron failed to adequately reflect the deterioration in the value of the its investments in long-term assets and in its broadband assets and content services business. In fact, the assets were not worth anywhere near what Enron reported in its financial statements.

157. As a result of these factors, the Enron Defendants knew that the assets would not provide the benefits estimated when they were acquired, but in order to report inflated earnings to investors, did not take required writedowns as per SFAS No. 121.

158. On 10/16/01, Enron belatedly announced that it was writing off $1 billion in assets. The release stated:

> Non-recurring charges totaling $1.01 billion after-tax, or $(1.11) loss per diluted share, were recognized for the third quarter of 2001.
>
> * * *
>
> Enron's results in the third quarter of 2001 include after-tax non-recurring charges of $1.01 billion, or $(1.11) per diluted share, consisting of:
>
> – $287 million related to asset impairments recorded by Azurix Corp. These impairments primarily reflect Azurix's planned disposition of its North American and certain South American service-related businesses;

- $180 million associated with the restructuring of Broadband Services, including severance costs, loss on the sale of inventory and an impairment to reflect the reduced value of Enron's content services business; and
- $544 million related to losses associated with certain investments, principally Enron's interest in The New Power Company, broadband and technology investments, and early termination during the third quarter of certain structured finance arrangements with a previously disclosed entity.

159. In fact, these and other long-term assets were impaired long before Enron recorded these write-offs.

India-Dabhol Power Plant Project

160. In the early 90s, as economic reforms were opening up India's economy, Enron Development became involved in building a 2,015 megawatt gas-fired combined cycle power project near Dabhol, India. However, the construction costs resulted in such huge cost overruns such that to ever recover its investment, Enron would have to charge electricity rates so far in excess of existing rates in the region that such rates would never be collected. Consequently, the valuation of Dabhol was grossly inflated and should have been written down as alleged below. Originally, the first phase was to begin construction in 94 and begin commercial operation in early 97. The second phase was to begin construction in 95. The project was dogged with problems from the beginning. In 95, after $300 million in work had been completed, the project was halted due to political changes in India. Enron had to agree to lower the rates it would charge for power once it was online to get it started again. However, even by 02, the project was still not finished.

161. By late 01, Enron and its partners had invested more than $1 billion in building Dabhol, but these costs were not recoverable. The problem was that the rates envisioned for consumers in India were several times higher than other rates in the country. Additionally, Enron continued to have regulatory/political problems in finalizing the project.

162. As *The Wall Street Journal* subsequently reported:

> Enron arrived in India in the early 1990s after a wave of economic reforms started prying open [India's] protected economy. Dabhol [Power Corp., Enron's struggling project which shut down earlier this year] has been dogged by controversy almost from the start and has emerged as an icon of the challenges facing foreign investors here. In the past year, its ***only*** customer, the Maharashtra State Electricity Board, stopped buying electricity from Dabhol, saying its rates were too high. The plant shut down and Dabhol took steps toward terminating its contract with the MSEB.

163. The Enron Defendants improperly failed to record an impairment charge as required by SFAS No. 121 for its investment in Dabhol, because doing so would have been a de facto admission that the project was a failure, and would have adversely affected earnings.

164. Ultimately, as Enron has sought to sell its interest in Dabhol, buyers demanded as much as a 70% discount from Enron's reported equity to buy its interest. Enron's failure to properly report the value of Dabhol artificially inflated the Company's earnings and assets during the Class Period.

Brazil

165. Enron also misstated its investments in projects in Brazil, including in electricity distributor Electricidade e Servicos SA ("Elektro"). In 7/98, Enron had paid $1.2 billion for a controlling stake in Elektro. It was a high price for the interest since Enron had been forced to outbid 17 other bidders, and represented a 98.9% premium over the minimum price. JP Morgan helped Enron make this purchase receiving millions of dollars in M&A advisory fees on the transactions.

PromiGas

166. PromiGas was a public Columbian company that held interests in a pipeline Enron had a 42% interest in, which the Company purchased in 98. Enron carried the investment on its books at $80 million. Then, each quarter Enron would purchase additional stock to drive up the share price until it was worth $123 million. Enron recorded income from the increase in value of PromiGas. Enron did not record the impairment in this investment when it declined in value and eventually had to transfer it to Whitewing when it could not unload it.

I. Enron's Financial Statements Violated GAAP

167. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);

(c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);

(d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

(e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

(g) The principle of completeness, which means that nothing is left out of the information that be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and

(h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

168. Further, the undisclosed adverse information concealed by defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

ENRON'S FALSE AND MISLEADING STATEMENTS IN ITS 10-KS AND REGISTRATION STATEMENTS

169. Enron's Registration Statements, used to sell securities that were purchased during the Class Period, incorporated by reference Enron's 10-K reports ("Offering Documents") for the Class Period offerings of Enron's securities:

Registration Dates for Enron Offerings During the Class Period

Date of Offering	Effective Date of Registration Statement	Description of Offering	10-K Incorporation
10/20/97	9/12/97	Enron Corp. 6.625% Notes due 10/15/2003 ($100 million)	Registration Statement and Prospectus incorporates 96 10-K Future filings incorporated in Registration Statement include 97 Form 10-Q's
11/6/97	9/12/97	Enron Corp. Remarketed Reset Notes due 11/15/2037 ($200 million)	Registration Statement and Prospectus incorporates 96 10-K Future filings incorporated in Registration Statement include 97 Form 10-Q's
11/13/97	9/12/97	Enron Corp. 6.45% Notes due 11/15/2001 ($300 million)	Registration Statement and Prospectus incorporates 96 10-K Future filings incorporated in Registration Statement include 97 Form 10-Q's

Date of Offering	Effective Date of Registration Statement	Description of Offering	10-K Incorporation
11/19/97	9/12/97	Enron Corp. 6.625% Notes due 2005 ($250 million)	Registration Statement and Prospectus incorporates 96 10-K Future filings incorporated in Registration Statement include 97 Form 10-Q's
5/5/98	4/21/98	Enron Corp. 34.5 million shares common stock	Registration Statement incorporated 97 10-K Future filings incorporated in Registration Statement include 1stQ 98 Form 10-Q
7/7/98	12/19/97	Enron Corp. 6.40% Notes due 7/15/2006 ($250 million) and Enron Corp. 6.95% Notes due 7/15/2028 ($250 million)	Registration Statement and Prospectus incorporates the 96 10-K Future filings incorporated in the Registration Statement include the 97 10-K
9/25/98	9/25/98	Enron Corp. Floating Rate Notes due 3/30/2000	Registration Statement and Prospectus incorporates the 96 10-K Future filings incorporated in the Registration Statement includc the 97 10-K

170. These Offering Documents were false and misleading due to, among other things, the incorporation by reference of Enron's Form 10-Ks for 96-97. As noted in ¶¶106-168, these 10-Ks contained Enron's admittedly false financial statements for 96 and 97. These financial statements understated Enron's debt by billions of dollars and overstated its earnings by hundreds of millions of dollars. These documents also included false and misleading financial ratios and other materially false statements. For example, the Offering Documents for the 7/7/98 offering of $500 million in notes was false due to the misrepresentation of Enron's reported ratio of earnings to fixed charges of 2.70 for the three months ended 3/31/98. This figure was materially false and misleading due to Enron's failure to consolidate Chewco and JEDI as required by GAAP, as detailed herein. The

Registration Statement for the 10/20/97, 11/6/97, 11/13/97, 11/19/97, 5/5/98, 7/7/98, and 9/25/98 offerings also incorporated the Form 10-Q for the 3rdQ 97, which reported that EES had incurred a loss of $64 million for the nine months ended 9/30/97. This amount understated the actual losses incurred by EES due to the overvaluation of Enron's EES contracts and abuse of mark-to-market accounting as detailed herein.

171. The 12/19/97 Registration Statement, which incorporated Enron's Form 10-K for the year-ended 12/31/96, also reported that Phase I of Enron's Dabhol plant was to begin commercial operations in 12/98. This was false and misleading because cost overruns on the Dabhol project and problems with political and regulatory officials, which had occurred by 12/19/97, ensured that the plant would likely never begin commercial operations on the terms represented and, if begun, commercial operations would result in huge losses because to break even Enron would have to charge its only customer (the Indian state government) four times the price other power generators were charging to supply electricity energy in order to recoup Enron's investment.

172. The Registration Statements also incorporated by reference all documents filed pursuant to §13(a) of the 1934 Act prior to the respective offerings, including Enron's subsequently filed Form 10-Ks, which misrepresented Enron's financial results, including earnings, the debt-to-equity ratio, total debt, and shareholder equity, by failing to consolidate non-qualifying SPEs, as required by GAAP and numerous other accounting misstatements, as described in ¶¶106-168. The subsequently filed Form 10-Qs were also incorporated by reference, and contained unaudited financial statements which were false and misleading as described therein. Enron has admitted these financial results were materially false. The 12/19/97 Registration Statement, for instance, incorporated the 97 Form 10-K since it was issued prior to the 5/5/98 stock offering and the 7/7/98 notes offering. The 97 Form 10-K misstated and understated the loss incurred by EES for 97, reported as $107 million, due to the overvaluation of the EES contracts and abuse of mark-to-market accounting, as detailed herein.

173. The Offering Documents also made false and misleading statements about Enron's financial-risk management and credit risk, concealing the substance, nature, and effect of the straw transactions Enron was entering with the bankers. Contrary to the house of cards defendants had

created in Enron, the Offering Documents gave the impression that Enron had hedged risk in its earnings and equity and thus Enron's finances were secure and its stock price sound.

174. The lawyers who wrote the Offering Documents and the banks who sold Enron's securities to the public via those Offering Documents were in a unique position to know that the statements made concerning Enron's financial risk management and credit risk in the Offering Documents for the securities offerings that they underwrote were false and misleading. Accordingly, not only did the banks know that Enron was leveraging billions in its own stock in bogus hedging transactions, they also quantified the financial and credit risk to Enron in structuring the hedging transactions and through value-at-risk, stress-testing and scenario analyses.

INVOLVEMENT OF THE BANKS

A. General

175. Wall Street underwriters play an extremely important – indeed indispensable role – in protecting investors in public companies and ensuring that public companies and those associated with public companies comply with their obligations of full, fair and complete disclosure when selling securities to the public.

> By associating himself with a proposed offering, an underwriter impliedly represents that he has made such an investigation in accordance with professional standards. Investors properly rely on this ***added protection which has a direct bearing on their appraisal of the reliability of the representations in the prospectus***. The underwriter who does not make a reasonable investigation is derelict in his responsibilities to deal fairly with the investing public.

In re Richmond Corp., 41 SEC 398, 406 (1963). In *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341, 370 (2d Cir. 1973), the Second Circuit stated:

> Self-regulation is the mainspring of the federal securities laws. ***No greater reliance in our self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter***. He is most heavily relied upon to verify published materials because of his expertise in appraising the securities issue and the issuer, and because of his incentive to do so. He is familiar with the process of investigating the business condition of a company and possesses extensive resources for doing so. Since he often has a financial stake in the issue, he has a special motive thoroughly to investigate the issuer's strengths and weaknesses. ***Prospective investors look to the underwriter – a fact well known to all concerned and especially to the underwriter – to pass on the soundness of the security and the correctness of the registration statement and prospectus.***

In *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643, 697 (S.D.N.Y. 1968), the court emphasized the importance of independent verification by underwriters:

> The purpose of Section 11 is to protect investors. To that end the underwriters are made responsible for the truth of the prospectus. If they may escape that responsibility by taking at face value representations made to them by the company's management, then the inclusion of underwriters among those liable under Section 11 affords the investors no additional protection. To effectuate the statute's purpose, the phrase "reasonable investigation" must be construed to require more effort on the part of the underwrites than the mere accurate reporting in the prospectus of "data presented" to them by the company. It should make no difference that this data is elicited by questions addressed to the company officers by the underwriters, or that the underwriters at the time believe that the company's officers are truthful and reliable. ***In order to make the underwriters' participation in this enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them. They may not rely solely on the company's officers or on the company's counsel. A prudent man in the management of his own property would not rely on them.***

Finally, in *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 582 (E.D.N.Y. 1971), the court stated that underwriters

> are expected to exercise ***a high degree of care in investigation and independent verification of the company's representations***. Tacit reliance on management assertions is unacceptable; the underwriters must play devil's advocate.

The banks named as defendants in this action grossly violated these duties in their dealings with Enron.

176. Each of the banks named as defendants knew:

(a) Enron was engaging in non-arm's-length transactions with another limited partnership and associated SPE known as Chewco, which was also permitting Enron to artificially inflate its reported earnings while moving large amounts of debt off its balance sheet;

(b) Enron's actual financial condition and results from operations were far worse than what was being publicly disclosed or presented: (i) because Enron was falsifying its financial results and misusing and abusing mark-to-market accounting, Enron's profitability was far less than publicly reported; (ii) because Enron was improperly moving debt off its balance sheet and onto the balance sheets of entities it secretly controlled, Enron's true debt level and leverage was much higher than what was being publicly presented; and (iii) because of the foregoing, Enron's liquidity and creditworthiness were far worse than publicly known and its financial condition much more leveraged and precarious than was being disclosed to public investors; and

(c) Enron had entered into a number of transactions with secretly controlled SPEs, which would require Enron to issue millions of shares of Enron common stock. If Enron's common stock fell below trigger prices ranging from \$83-\$19 per share, the debt of the SPEs with which Enron was doing business would not, in fact, be non-recourse to Enron as represented but, in fact, would become and be recourse to Enron if, as and when Enron's credit rating was lowered – something each of the banks named as defendants knew would occur if, as and when Enron's true financial condition became public or became known to the rating agencies.

B. Involvement of JP Morgan

177. JP Morgan is a banking enterprise which had an extensive and extremely close relationship with Enron. During the Class Period, JP Morgan provided commercial banking and investment banking services to Enron, helped structure or finance one or more of Enron's illicit partnerships or SPEs, and helped Enron falsify its financial statements and misrepresent its financial condition by hiding almost \$4 billion in debt that should have been on Enron's balance sheet, while its securities analysts were issuing extremely positive – and false and misleading – reports on Enron, extolling its business success, the strength of its financial condition and its prospects for strong earnings and revenue growth. In return for JP Morgan's participation in the scheme, on top of the huge underwriting and consulting fees, interest payments, commitment fees and other payments, JP Morgan received from Enron and related entities, top executives of JP Morgan were permitted to personally invest in Enron related partnerships as a reward to them for orchestrating JP Morgan's participation in this fraud.

178. In interacting with Enron, JP Morgan functioned as a consolidated and unified entity. There was no so-called "Chinese Wall" to seal off the JP Morgan securities analysts from the information which JP Morgan obtained rendering commercial and investment banking services to Enron. Alternatively, even if some restrictions on the information made available to JP Morgan's securities analysts existed, those unilateral and self-serving actions are insufficient to prevent imputation of all knowledge and scienter possessed by the JP Morgan legal entity, as its knowledge and liability in this case is determined by looking at JP Morgan as an overall legal entity.

179. JP Morgan acted as an underwriter (or reseller) of billions of dollars of Enron securities. For instance:

DATE	SECURITY
10/97	$100 million 6.625% Enron notes
5/98	34.5 million shares Enron common stock at $25 per share
7/98	$500 million 6.40% and 6.95% Enron notes

180. During the Class Period, JP Morgan was also one of the principal lending banks to Enron, acting with CitiGroup as a lead bank on Enron's main credit facilities, loaning over a billion dollars to Enron, while helping to syndicate over $4 billion in bank loans to Enron or related entities. For instance:

DATE	TRANSACTION
5/98	$500 million loan to JEDI
8/98	$1 billion credit line to back up Enron commercial paper
8/98	$1 billion loan to finance purchase of Brazilian electricity distribution company

181. JP Morgan was willing to engage and participate in the ongoing fraudulent scheme because such participation created enormous profits for JP Morgan as long as the Enron scheme continued in operation – something that JP Morgan was in a unique position to cause to occur. While JP Morgan was lending hundreds of millions of dollars to Enron and syndicating hundreds of millions of additional loans, it was receiving huge fees and interest payments for those loans and syndication services. However, JP Morgan was limiting its own risk in this regard, as it knew that with either its help or the help of other banks which were part of the scheme, so long as Enron maintained its investment grade credit rating and continued to report strong current period financial results and credibly forecast strong ongoing revenue and profit growth, Enron's access to the capital markets would continue to enable Enron to raise hundreds of millions, if not billions, of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from JP Morgan to Enron so that the Enron Ponzi scheme could continue. In fact, the proceeds of Enron's securities offerings during the Class Period underwritten by JP Morgan or

other investment banks were utilized to repay Enron's existing commercial paper and bank indebtedness, including indebtedness to JP Morgan. Thus, throughout the Class Period, JP Morgan was pocketing millions of dollars a year in interest payments, syndication fees and investment banking fees by engaging and participating in the Enron scheme to defraud and stood to ***continue*** to collect these huge fees on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme, while its top executives or managing directors pocketed huge returns on their investment in LJM2 – returns created by the very manipulative devices and transactions that were hiding Enron's debt and artificially inflating its profit.

182. In addition, JP Morgan also engaged and participated in the scheme to defraud by the additional actions set forth below. First of all, the Registration Statements and Prospectuses for the Enron securities sales where JP Morgan was one of the lead underwriters contained false and misleading statements – ***which are statements made by JP Morgan as an underwriter*** – including false interim and annual financial statements, and false statements concerning the structures of and Enron's relationship to SPEs and related parties, as well as the value and condition of Enron's business operations and assets. JP Morgan has liability for its participation in Enron's 10/97 $100 million Note offering.

183. Deleted.

184. In addition to its own direct liability for making false and misleading statements, JP Morgan also engaged and participated in and furthered the fraudulent scheme by helping to finance or otherwise participate in manipulative devices and illicit transactions with Enron which it knew would contribute materially to Enron's ability to continue to falsify its financial condition. During the Class Period, JP Morgan and Enron engaged in fraudulent transactions utilizing an entity which JP Morgan secretly controlled, known as Mahonia, located in the Channel Islands between England and France. From 12/92 to 9/01, Enron received from JP Morgan more than $3.7 billion in bogus cash flow and hidden debt. These transactions were structured to appear as natural gas futures contracts, *i.e.*, commodity trades, between Enron and the Mahonia entity, which JP Morgan actively controlled. However, these transactions were contrivances. The parties to those transactions never intended in fact to close out any of the natural gas futures contracts. These transactions were, in

reality, disguised loans from JP Morgan to Enron, a contrivance JP Morgan created to get cash to Enron to boost its apparent liquidity while concealing over $3.7 billion in debt that should have been reported on Enron's balance sheet.

185. JP Morgan knew these transactions were manipulative devices and contrivances and that, given the true financial condition of Enron, there was a risk Enron would default and JP Morgan would suffer a loss. Therefore, JP Morgan attempted to protect itself against such loss by insuring the contracts. When Enron went bankrupt, JP Morgan attempted to collect on the insurance. However, the insurance carriers that issued surety bonds covering the "commodities trades" between JP Morgan-controlled entities and Enron have refused to pay JP Morgan's losses, asserting the trades ***were fraudulent and used to conceal what were, in fact, loans from JP Morgan to Enron***. According to a federal District Court opinion denying JP Morgan's attempt to force the insurance companies to honor the surety bonds.

186. On 3/5/02, *Dow Jones* reported:

> A federal judge denied J.P. Morgan [Chase's] request for an immediate ruling in its dispute with insurers over nearly $1 billion in bonds on Enron Corp. oil and gas contracts.
>
> * * *
>
> The insurers recently claimed in court filings that J.P. Morgan may have deliberately camouflaged bank loans to Enron as commodity transactions. The bank's actions would have helped Enron disguise debts, the insurers claim.
>
> * * *
>
> The insurers made commitments in the form of surety bonds of about $1.1 billion, of which JP Morgan's share is about $965 million. The bonds guaranteed that Enron would deliver natural gas and oil to the bank's Mahonia Ltd. energy-trading affiliate.
>
> In rejecting J.P. Morgan's request for summary judgment, Judge Rakoff cited evidence that appears to show that Enron agreed to ***purchase $394 million in gas from an entity called Stoneville Aegean Ltd. on the same day it agreed to sell the same quantities of gas to Mahonia.***
>
> ***The judge said Mahonia and Stoneville seem to be offshore corporations controlled by the same director, Ian James, and the same shareholders. The fact that the entities appear linked makes the Enron transactions "even more suspicious" he wrote.***
>
> ***The court "could not possibly grant judgment" to J.P. Morgan because "taken together, then, these arrangements now appear to be nothing but a disguised loan,"*** the judge ruled.

187. These phony commodity transactions were overseen and manipulated by Mark Shapiro, a senior credit officer at JP Morgan, who kept other top JP Morgan officials informed of the status of these multi-billion dollar transactions. These transactions were frequently entered into ***just before quarter- or year-end so that they would enable Enron to keep debt off its balance sheet by disguising it as commodities trades, thus keeping Enron's debt level down, helping to maintain its investment grade credit rating, and allowing the Enron Ponzi scheme to continue.***

C. Involvement of CitiGroup

188. CitiGroup is a financial services enterprise that provided both commercial banking and investment banking services to Enron, helped to structure and finance one or more of Enron's illicit partnerships or SPEs and helped it conceal billions of dollars of debt from Enron's balance sheet, while its securities analysts were issuing extremely positive – but false and misleading – reports on Enron extolling its business success, the strength of its financial condition and its prospects for strong future earnings and revenue growth. In addition to the huge underwriting, advisory and transactional fees, and interest and commitment charges CitiGroup was receiving from Enron and related entities, in return for and as a reward for CitiGroup's participation in the scheme, CitiGroup or certain CitiGroup executives were permitted to invest in Enron related partnerships.

189. In interacting with Enron, CitiGroup functioned as a consolidated and unified entity. There was no so-called "Chinese Wall" to seal off the CitiGroup securities analysts from the information which CitiGroup obtained in rendering commercial and investment banking services to Enron. Alternatively, even if some restrictions were placed on the information made available to CitiGroup's securities analysts, that unilateral and self-serving action is insufficient to prevent the imputation of all knowledge (and scienter) possessed by the CitiGroup legal entity, as its knowledge and liability in this case is determined by looking at CitiGroup as an overall legal entity.

190. CitiGroup acted as an underwriter for Enron securities. For instance:

DATE	SECURITY
11/93	8 million shares Enron capital 8% preferred shares at $25 per share
7/94	3 million shares 9% Enron capital preferred shares at $25 per share
1/95	$150 million 8-1/2% Enron notes
5/95	$150 million 7-1/8% Enron notes
9/95	$50 million 6-3/4% Enron notes
12/95	$210 million Enron exchangeable notes
11/96	8 million shares 8.3% Enron capital preferred shares at $25 per share
1/97	6 million shares Enron Capital Trust II 8-1/8% Preferred Securities at $25 per share
8/97	$150 million 6.5% Enron notes
11/97	$300 million 6.45% Enron notes
9/98	$250 million Enron floating-rate notes

191. In addition, during the Class Period, CitiGroup was one of the principal lending banks to Enron, acting with JP Morgan as lead bank on Enron's main credit facilities, loaning hundreds of millions of dollars to Enron itself and helping to syndicate bank loans to Enron. For instance:

DATE	TRANSACTION
5/98	$500 million loan to JEDI

192. CitiGroup took unusual steps to mitigate its credit exposure to Enron because of its knowledge that Enron's true financial condition was much more precarious than publicly disclosed and that Enron was falsifying its true financial condition and financial results. To try to insulate itself from the losses it faced due to Enron's true financial condition and fraudulent course of business, CitiGroup created securities that functioned like an insurance policy for its credit exposure to Enron. If Enron remained solvent and strong, buyers of the securities would receive a steady return, but if Enron was unable to pay its bank debt, CitiGroup would stop paying the return, keep the investors' principal and instead give them Enron's now worthless or impaired debt. The companies sold investors a type of credit derivative called credit-linked notes. If the notes' five-year terms elapsed without incident, CitiGroup would return the investors' principal. But if Enron went

bankrupt, CitiGroup would take possession of the highly rated securities and give the investors unsecured Enron debt instead. The notes worked like an insurance policy: CitiGroup paid a premium in the form of interest payments, and if Enron collapsed, the bank would receive significant compensation in the form of high-quality securities. ***This hedge was CitiGroup's largest against any company in its history. In fact, this hedge was the largest of its kind ever.***

193. CitiGroup was willing to engage and participate in the ongoing fraudulent scheme because such participation created enormous profit for CitiGroup as long as the Enron scheme continued in operation – something that CitiGroup was in a unique position to help occur. While CitiGroup was lending hundreds of millions to Enron and syndicating hundreds of millions of additional loans, it was receiving huge fees and interest payments for those loans and syndication services. However, in addition to the very unusual credit hedging transactions pleaded above, CitiGroup had limited its risk, as it knew that either with its help or the help of other banks which were part of the scheme, so long as Enron maintained its investment grade credit rating and continued to report strong current period financial results and credibly forecast strong ongoing revenue and profit growth, Enron's access to the capital markets would continue to enable Enron to periodically raise hundreds of millions, if not billions, of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from CitiGroup to Enron so that the process could continue. In fact, the proceeds of Enron's Class Period securities sales, including offerings CitiGroup helped underwrite, were utilized in significant part to repay Enron's existing commercial and bank indebtedness, including indebtedness to CitiGroup, while other securities offerings accomplished by Enron utilizing other banks which were participating in the scheme, were also used to repay existing bank indebtedness, including monies owed to CitiGroup. Thus, throughout the Class Period, CitiGroup was pocketing millions of dollars a year in interest payments, and syndication and investment banking fees by engaging and participating in the Enron scheme to defraud and stood to ***continue*** to collect these huge fees on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme.

194. CitiGroup also participated in and furthered the fraudulent scheme by helping to finance or otherwise participate in illicit transactions with Enron which it knew would contribute

materially to Enron's ability to continue to falsify its financial condition and thus continue the operation of the Enron Ponzi scheme. From 94 through 12/98, CitiGroup lent Enron $700 million in a series of manipulative devices and transactions – prepaid swaps conducted via CitiGroup's Cayman Island subsidiaries called Delta and Roosevelt. In a true swap, two parties trade the future returns on investments over a set period of time.. One party pays a small amount to receive a fixed interest rate on a corporate bond in lieu of uncertain gains on the same corporation's stock. The counterparty accepts the payment and swaps the return on the bond for the return on the stock. Neither party actually needs to hold the underlying assets, as long as the payments are made. Typically, neither party in a true swap exchange receives all the agreed payments up front. In the Enron transactions, though, CitiGroup paid up front an estimate of the fair value of its portion of the swaps – hundreds of millions of dollars each time – payments made ***immediately. Enron was obliged to repay the cash over five years***. These Delta transactions, though technically derivatives trades known as prepaid swaps, perfectly replicated loans and were, in fact, manipulative devices to disguise what were, in reality, loans. Enron's balance sheet misrepresented these transactions. Enron posted the loans as "assets from price risk management" and as "accounts receivable," admitted Charlie Leonard, a spokesperson for Andersen. The repayments that Enron owed the banks were listed as "liabilities from price risk management" and possibly a small amount as accounts payable, Leonard said.

194.1 CitiGroup also participated in and furthered the fraudulent scheme by structuring, funding and executing "minority interest transactions" to falsify Enron's reported financial results and debt. "Project Nighthawk enabled Enron to raise over $500 million to repay Enron corporate debt .... The result was a 9% improvement in Enron's debt-to-equity ratio at year-end 1997." Examiner's Second Report, App. I, Annex 1 at 2.

> In a July 1997 marketing presentation, CitiGroup explained to Enron that Nighthawk's benefits would include: (i) the transaction would receive significant equity credit from Rating Agencies; (ii) it would not dilute Enron's earnings per share because the Enron common shares would not be deemed to have been issued unless and until the preferred stock was converted; (iii) Enron would maintain control over all preferred shares transferred to the majority-owned subsidiary; and (iv) the transaction would remain "confidential" with "minimal public disclosure." Thus, CitiGroup knew that Nighthawk would accomplish a number of benefits for Enron, including obtaining financing that would not increase its debt, would not cause it to

> relinquish control over its assets, and would help it maintain a favorable credit rating. CitiGroup also knew that Enron had a desire to obtain these benefits before year-end 1997.

Examiner's Third Report, App. D, at 93 (footnotes omitted).

194.2 The Nighthawk transaction closed on 12/27/97. Enron contributed shares of its convertible preferred stock to Whitewing and borrowed $500 million from Whitewing. CitiGroup was rewarded with a $9+ million structuring fee for its role in the fraud.

195. In addition, CitiGroup ***issued*** analysts' reports on Enron which contained false and misleading statements concerning Enron's business, finances and financial condition and its prospects. These were all statements by CitiGroup to the securities markets which helped to artificially inflate the trading prices of Enron's publicly traded securities. Keeping Enron's stock price inflated was important to CitiGroup as it knew that if the stock price fell below certain "trigger" prices, Enron would be required to issue millions of additional Enron shares which would reduce Enron's shareholders' equity by hundreds of millions, if not billions, of dollars, endangering its investment grade credit rating, cutting off access to the capital markets and thus endangering the ongoing operations of the scheme from which CitiGroup was profiting.

¶¶196-218 Deleted.

G. Involvement of Barclays

219. Barclays is a huge financial services institution that had an extensive and extremely close relationship with Enron. During the Class Period, Barclays provided both commercial banking and investment banking services to Enron, help structure and finance one or more of Enron's illicit partnerships or SPEs, including the critical year-end 97 deal whereby Chewco was formed to buy out an outside investor's interest in JEDI.

220. Barclays later acted as a placement agent and/or reseller with respect to the following public offerings of Enron securities:

DATE	SECURITY
2/01	$1.9 billion zero coupon convertible notes

221. In addition, Barclays later underwrote the sale of Enron-related securities. For instance:

2/00 $240 million 8.75% Yosemite Enron linked obligations

222. In addition, during the Class Period, Barclays was one of the principal commercial lending banks to Enron participating in over $3 billion in bank loans to Enron. For instance:

- Barclays was the lead lender on a $2.3 billion debt facility to finance Enron's purchase of Wessex Water in 98.
- Barclays was a co-arranger of a $250 million loan to Enron in 11/97.
- Barclays participated in the 9/98 $1 billion credit facility for Enron as well as the 8/01 $3 billion debt facility for Enron which were used to back up Enron's commercial paper debt.
- Barclays participated in a $250 million revolving credit facility for Enron arranged in 11/98.
- Barclays helped arrange and participated in a $500 million credit facility for JEDI in 5/98.

223. Barclays was willing to participate in the ongoing fraudulent scheme because such participation provided enormous profits for Barclays as long as the Enron scheme could be continued – something that Barclays was in a unique position to help occur. While Barclays was participating in the lending of hundreds of millions of dollars to Enron, it was receiving huge fees. However, Barclays was limiting its risk in this regard as it knew that either with its help or the help of other banks which were part of the scheme, so long as Enron maintained its investment grade credit rating and continued to report strong current period financial results and credibly forecast strong ongoing revenue and profit growth, Enron's access to the capital markets would continue to enable Enron to periodically raise hundreds of millions if not billions of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from Barclays to Enron so that the process could continue. In fact, the proceeds of almost all of Enron's securities sales during the Class Period, including those where Barclays acted as an underwriter, were utilized in significant part to repay Enron's existing commercial paper and bank indebtedness, including indebtedness to Barclays. Thus, during the Class Period, Barclays was pocketing millions of dollars a year in interest payments, syndication fees and investment banking fees by participating in the

Enron scheme to defraud and stood to continue to collect these huge fees on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme.

224. Barclays also participated in and furthered the fraudulent scheme by helping to finance or otherwise participate in illicit transactions with Enron which it knew would contribute materially to Enron's ability to continue to falsify its financial condition and thus continue the operation of the Enron Ponzi scheme. In addition to participating in billions of dollars of loans to Enron and to entities associated with the SPEs Enron secretly controlled as pleaded above, during the Class Period, Barclays and Enron engaged in fraudulent transactions utilizing an entity which Barclays secretly controlled, known as Chewco.

225. In late 97, with the help of Barclays, Enron's insiders quickly structured a new entity called Chewco to buy out the other investor's interest in JEDI. This required that Chewco receive significant bank financing and have independent equity investors which held 3% of Chewco. Barclays agreed to loan $240 million to Chewco on unusually favorable terms, receiving not only high interest rate payments but very significant commitment and lending fees, as well as a guarantee of the loan by Enron. ***In addition, Barclays agreed to make available approximately $11.4 million in what were called "equity loans"*** to the purported equity investors in Chewco. However, because Barclays knew those equity investors were, in fact, straw persons controlled by Enron, who did not have any real credit standing, Barclays demanded that Chewco provide a secret $6.6 million cash deposit with Barclays to offset the so-called "equity loans" Barclays had made to those straw persons. ***Thus, Barclays knew the structure of the Chewco partnership was a sham and that, in fact, it was an entity with little or no outside equity in it, which it and Enron had formed for the purpose of preventing a disastrous unwinding or restatement of Enron's previously reported 97 profits and to create a secretly controlled entity that Enron could use going forward to do other non-arm's-length transactions with to generate huge profits and to move billions of dollars of debt off its balance sheet.***

226. Barclays' financing and participation in Chewco was an essential and integral part of Enron's scheme of concealing its true debt levels by moving billions of dollars of debt off its books and onto the books of SPEs it secretly controlled, while improperly recognizing millions of dollars

235. During the Class Period, Lehman Brothers knew that Enron was falsifying its publicly reported financial results and that its true financial condition was much more precarious than was publicly known. It obtained this knowledge due to its access to Enron's internal business and financial information as Enron's lead lending bank, as well as its intimate interaction with Enron's top officials which occurred virtually on a daily basis.

236. Thus, Lehman Brothers is directly liable to the Class for making false and misleading statements in Registration Statements and Prospectuses utilized by Enron and Lehman Brothers to raise billions of dollars of new capital for Enron, for false and misleading statements in analysts' reports written and issued by Lehman Brothers, which helped to artificially inflate the trading price of Enron's publicly traded securities, as well as for its knowing participation in a fraudulent scheme, course of conduct and fraudulent course of business of Enron, which operated to defraud purchasers of Enron's publicly traded securities during the Class Period.

¶¶237-247 Deleted.

J. Involvement of Deutsche Bank

248. Deutsche Bank is a huge banking enterprise that had an extremely close relationship with Enron. During the Class Period, Deutsche Bank provided commercial banking and investment banking services to Enron, helped structure or finance one or more of Enron's illicit partnerships or SPEs and helped Enron falsify its financial statements and misrepresent its financial condition, while its securities analysts were issuing extremely positive reports on Enron extolling its business success, the strength of its financial condition and its prospects for strong earnings and revenue growth.

249. Deutsche Bank's relationships with Enron were so extensive that top officials of the bank constantly interacted with top executives of Enron, *i.e.*, Lay, Skilling, Causey, McMahon or Fastow, on almost a daily basis throughout the Class Period, discussing Enron's business, financial condition, financial plans, financing needs, its partnerships and SPEs and Enron's future prospects. Deutsche Bank actively engaged and participated in the fraudulent scheme and furthered Enron's fraudulent course of conduct and business in several ways. It participated in loans worth billions of dollars to Enron during the Class Period, it helped it raise over $5 billion from the investing public via the sale of the securities of Enron and Enron-related entities during the Class Period, it helped

it structure and finance certain of the illicit SPEs and partnerships Enron controlled which were primary vehicles utilized by Enron to falsify its reported financial results and engaged in transactions with Enron to disguise loans to Enron and help Enron falsify its true financial condition, liquidity and creditworthiness.

250. In interacting with Enron, Deutsche Bank functioned as a consolidated and unified entity. There was no so-called "Chinese Wall" to seal off the Deutsche Bank securities analysts from the information which Deutsche Bank obtained rendering commercial and investment banking services to Enron. Alternatively, even if some restrictions on the information made available to Deutsche Bank's securities analysts existed, that unilateral and self-serving action was insufficient to prevent the imputation of all knowledge (and scienter) possessed by the Deutsche Bank legal entity, as its knowledge and liability in this case is determined by looking at Deutsche Bank as an overall legal entity.

251. Deutsche Bank acted as an underwriter for billions of dollars of Enron securities. For instance:

DATE	SECURITY
1/97	6 million shares 8-1/8% Enron capital preferred shares at $25 per share

252. During the Class Period, Deutsche Bank was also one of the principal commercial lending banks to Enron, acting with CitiGroup as a lead bank on Enron's main credit facilities, loaning over a billion dollars to Enron, while helping to syndicate over $4 billion in bank loans to Enron or related entities. For instance:

DATE	TRANSACTION
7/98	$252 million Enron loan
8/98	$1 billion Enron credit line to back up commercial paper

253. Deutsche Bank was willing to engage and participate in the ongoing fraudulent scheme because such participation created enormous profits for Deutsche Bank as long as the Enron scheme continued – something that Deutsche Bank was in a unique position to help occur. While Deutsche Bank was lending hundreds of millions to Enron and syndicating hundreds of millions of dollars of additional loans, it was receiving huge fees and interest payments for those loans and

syndication services. However, Deutsche Bank was limiting its own risk in this regard, as it knew that either with its help or the help of other banks which were part of the scheme, so long as Enron maintained its investment grade credit rating and continued to report strong current period financial results and continued to credibly forecast strong ongoing revenue and profit growth, Enron's access to the capital markets would continue to enable Enron to raise hundreds of millions if not billions of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from Deutsche Bank to Enron so that the Enron Ponzi scheme could continue. In fact, the proceeds of Enron's securities offerings during the Class Period underwritten by Deutsche Bank or other investment banks were utilized to repay Enron's existing commercial paper and bank indebtedness, including indebtedness to Deutsche Bank. Thus, throughout the Class Period, Deutsche Bank was pocketing millions of dollars a year in interest payments, syndication fees and investment banking fees by engaging and participating in the Enron scheme to defraud and stood to ***continue*** to collect these huge fees on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme.

254. Deleted.

255. During the Class Period, Deutsche Bank knew that Enron was falsifying its publicly reported financial results and that its true financial condition was much more precarious than was publicly known. It obtained this knowledge due to its access to Enron's internal business and financial information as Enron's lead lending bank, as well as its intimate interaction with Enron's top officials which occurred virtually on a daily basis.

256. Deutsche Bank is directly liable to the Class for making false and misleading statements in Registration Statements and Prospectuses utilized by Enron and Deutsche Bank to raise billions of dollars of new capital for Enron, for false and misleading statements in analysts' reports written and issued by Deutsche Bank, which helped to artificially inflate the trading price of Enron's publicly traded securities, as well as for its knowing participation in a fraudulent scheme, course of conduct and fraudulent course of business of Enron, which operated to defraud purchasers of Enron's publicly traded securities during the Class Period.

256.1 Deutsche Bank and its Bankers Trust division devised, structured and executed hundreds of millions of dollars in fraudulent tax schemes for Enron during the Class Period. And Deutsche Bank's false and misleading public statements concerning Enron were made with knowledge and/or reckless disregard for the true fact that Enron's reported income was the result of fraudulent transactions for which Deutsche Bank was responsible.

Enron's Bogus Income From Fraudulent Tax Schemes

256.2 Prior to and during the Class Period, Enron's financial results were materially and artificially inflated by fraudulent tax schemes. A joint House of Representatives and Senate Committee found, among other things, that these fraudulent tax schemes resulted in Enron paying no federal income tax in 96, 97, 98, 99 and 01. ***Enron recognized phony income of at least $651 million from tax schemes during 96-00*** – approximately 20% of Enron's earnings in those years.[6] In total, these tax schemes resulted in benefits to Enron of over $2 billion from 96 forward.

256.3 Senate Finance Committee Chairman Charles E. Grassley, Iowa Republican, commenting upon the Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issue, and Policy Recommendations (the "Joint Committee Report"), proclaimed that the tax and accounting scheme ought be viewed as a "***shocking event in the history of American corporate tax policy and American corporate financial accounting***." Senator Grassley further commented that these findings proved "***Enron was a house of cards" built by "some of the nation's finest banks, finest accounting firms, and some of our best attorneys working together to prop up the biggest corporate farce of the century***."

Deutsche Bank and Bankers Trust Devised, Structured and Executed Enron's Fraudulent Tax Schemes

256.4 The primary architect of the tax wing of the Enron house of cards was Bankers Trust. Investigators for the Senate Finance Committee found that by 01, $446 million out of $651 million fraudulently inflated income from tax schemes at Enron was the result of transactions by Bankers Trust and Deutsche Bank. Congressmen have sought a response to this from the SEC. By letter

6 Enron's court appointed Bankruptcy Examiner, Neil Batson, estimates that Enron reported approximately $800 million in income from 95 through 9/01 as a result of fraudulent tax schemes.

dated 2/27/03, Congressmen Richard E. Neal and Edward J. Markey urged SEC Chairman William Donaldson to take all appropriate actions against Bankers Trust/Deutsche Bank for violations of federal securities regulations based on findings made in the Joint Committee Report. Their 2/27/03 letter summarized some of the findings in the 2,700 page Joint Committee Report as follows:

> In 1997, Bankers Trust (now owned by Deutsche Bank) promoted a structured tax transaction to Enron called "Steele," for which Bankers Trust received at least $8.2 million in fees. In a letter describing the accounting treatment to Mr. William S. McKee (a legal advisor on the transaction), Bankers Trust made it clear that a corporation would pay only a small fee for the tax benefits of the transaction. That fact is not surprising since the transaction would not give rise to significant cash benefits until the out years of the transaction, years eleven through twenty.
>
> However, Bankers Trust also made it clear that a corporation would pay a large fee for the transaction if it were structured to create short-term, pre-tax earnings. The Steele transaction was marketed to Enron as creating $120 million in pre-tax earnings over the first five years of the transaction even though significant cash benefits would not be realized until year eleven. The pre-tax earnings arguably were derived by treating the transaction as a "bargain purchase," even though Bankers Trust was quite explicit in the letter to Mr. McKee that there was "no bargain purchase from an economic perspective." ***Quite simply, Bankers Trust, with Mr. McKee's assistance, designed a transaction for Enron that artificially created $120 million in pre-tax earnings over five years ....***
>
> Bankers Trust also promoted another similar, but even larger transaction to Enron called "Cochise," again with Mr. McKee's assistance, netting Bankers Trust $11.2 million in fees. ***Both Steele and Cochise purported to create pre-tax operating earnings, enabling Enron to overstate its operating income, not merely show a reduction in its effective tax rate.*** Bankers Trust recognized that Enron would pay it a large fee for the earnings overstatement that the orchestrated transaction manufactured.
>
> Another transaction demonstrating how Bankers Trust and its legal advisors created artificial accounting benefits for Enron is the "Teresa" transaction marketed to Enron by Bankers Trust in 1997, and earning Bankers Trust over $8.8 million in fees. ***Teresa was designed to provide Enron with financial accounting income of over $200 million*** even though it involved a voluntary prepayment of Federal income tax by Enron, in return for tax benefits to be recognized over a 40-year period.
>
> * * *
>
> ***It is clear that the [Teresa] transaction was designed for the sole purpose of artificially inflating Enron's accounting income. Any doubt about the purpose of the transaction is eliminated by Mr. McKee's tax opinion which states that the predominate purpose of the transaction "was to generate income for financial accounting purposes." A more stark example of the abusive nature of the Enron structured transactions could not be imagined.***
>
> According to press reports, Merrill Lynch will pay fines totaling $80 million because of the SEC investigation of two transactions in which it participated that were designed to inflate Enron's earnings. We believe that the enforcement action was totally appropriate. Investment bankers and their advisors need to recognize that

there is a downside to the business of assisting companies in artificially creating earnings to report to shareholders.

> We would suggest that the Merrill Lynch transactions seem small in comparison to the financial overstatements facilitated by Bankers Trust ....

256.5 The individual investment bankers who were the architects responsible for Bankers Trust/Deutsche Bank's tax wing in Enron's house of cards were largely former Andersen personnel, who had worked in its New York office. These former Andersen partners, Managing Director Thomas Finley and Vice-Presidents Brian McGuire and William Boyle, and others, including Manuel Schneidman, collaborated to concoct the fraudulent tax transactions that inflated Enron's earnings. Since Bankers Trust/Deutsche Bank had a material role in falsely inflating Enron's earnings, analysts' reports extolling Enron were knowingly false. Moreover, numerous prospectuses for Enron securities sold by Bankers Trust/Deutsche Bank contained Enron's false financial statements that Bankers Trust/Deutsche Bank knew were false – Bankers Trust/Deutsche Bank had helped materially inflate Enron's earnings in those financial statements.

256.6 Each of the fraudulent transactions created by Bankers Trust violated the tax laws for they were knowingly and purposefully created to artificially inflate Enron's reported financials. Indeed, each transaction violated the "business purpose" tax rule, which requires all transactions to have a valid business purpose ***other than generating tax savings***. Despite the need for an independent "business purpose," each of the transactions devised by Bankers Trust had as its only business purpose to artificially inflate Enron's reported financial results. Indeed, this purported "business purpose" was included in the opinion letters documenting the Bankers Trust transactions. As put by John Buckley, chief tax counsel to the Democratic members of the Committee on Ways and Means and former chief of staff to the Joint Committee on Taxation: "'***All of these transactions have no real business purpose, unless you believe it's to artificially create income to report to shareholders***.'" Therefore, each transaction violated the securities laws and, because artificial inflation of financial results cannot reasonably be a valid business purpose under the federal income tax laws as written by Congress, each transaction violated applicable tax laws.

256.7 Furthermore, the Joint Committee Report found that Bankers Trust clearly knew that Enron's financial results were artificially inflated by these tax schemes – which is evident from the way each transaction was structured by Bankers Trust (these transactions are detailed at length below). In a 2/15/03 article, *The Washington Post* focused upon the Joint Committee Report's finding that Deutsche Bank/Bankers Trust acted with scienter in falsifying Enron's reported financial results through the fraudulent tax transactions. The article, referring to (among others) Bankers Trust, stated: "***Enron's motive in using the tax transactions to boost profits was clearly known by its bankers*** ...."

256.8 *The Washington Post* further focused upon the Joint Committee Report's finding that Bankers Trust had a strong motive to sell tax schemes that artificially inflated Enron's earnings. The article stated:

> ***William B. Boyle, a vice president for Bankers Trust*** -- a key partner in Enron's tax deals -- noted in a 1997 memo that clients would pay "little, if any fee" for a deal that produced a large reduction in actual taxes paid. But ***clients would be "extremely interested" and pay "a substantial fee" for a deal that combined tax savings with a large increase in earnings on their income statements***, he said.

256.9 While some of the fraudulent tax transactions devised by Bankers Trust/Deustsche Bank were created before the Class Period, each transaction resulted in the artificial inflation of Enron's reported financial results during the Class Period because each transaction resulted in the fraudulent recognition of income and purported tax savings going forward, resulting in the accrual of benefits years after the actual transaction closed. Indeed, Bankers Trust/Deutsche Bank had an additional motive to continue to conceal the truth (while making positive statements about the value of Enron's publicly traded securities) because Bankers Trust was paid for creating the fraudulent tax schemes in installments that went beyond the Class Period and because Bankers Trust knew that if Enron filed for bankruptcy these payments (in addition to Bankers Trust's tax schemes and Enron's financial statements) would be scrutinized and exposed as frauds. In fact, the Bankruptcy Examiner has done exactly that in his Second Interim Report.

256.10 Six of the fraudulent tax transactions involving Enron and Bankers Trust/Deutsche Bank are detailed below and in the following chart, which also demonstrates the collective impact of the transactions upon Enron's reported financial results:

Benefits and Fees of Enron's Various Structured Transactions with Bankers Trust/Deutsche Bank (97-01) (in millions)

Project Name	Financial Accounting Income through 2001	Total Projected Financial Accounting Income	Federal Tax Savings Through 2001	Total Projected Federal Tax Savings	Project Fees to Bankers Trust
Steele (1997)	65	83	39	78	10
Teresa (1997)	226	257	(76)	263	11
Cochise (1998)	101	143	---	141	15
Tomas (1998)	37	113	95	109	11.875
Renegade (1998)	1	1	0	0	---
Valhalla (2000)	16	64	0	0	---
TOTALS	446	661	58	591	47.875

Project Steele

256.11 Project Steele's beginnings can be traced to an 4/97 pitch by Bankers Trust of three alternative schemes to Enron. According to a Bankers Trust memorandum dated 6/2/97, the alternative versions of Project Steele enabled Enron to recognize tax benefits solely, or tax benefits coupled with financial accounting benefits. The two alternatives providing for both accounting and tax savings benefits provided for the largest fees to Bankers Trust. Enron and Bankers Trust signed an engagement letter on 7/17/97 and, after discussions in the summer and fall of 97, Enron and Bankers Trust decided to proceed with the version of Project Steele that both artificially inflated Enron's immediate (and near future) earnings and limited Enron's future tax payments. A more concrete agreement was signed 10/28/97 and the transaction was completed on 10/31/97.

256.12 Bankers Trust's role in Project Steele was crucial. Not only did Project Steele originate with Bankers Trust, but it was the exclusive financial advisor to Enron on the matter and ***Bankers Trust was the only unrelated counterparty to Enron in the transaction.***

256.13 A 3/31/03 *BusinessWeek* article – building upon the findings of the Joint Committee Report – stated with respect to Project Steele:

> The participants all say that the deal, which allowed Enron and [Bankers Trust] each to claim a deduction for the same pool of money-losing mortgage-backed securities owned by the investment bank, was legitimate. But now that the transaction has seen the light of day, it is being ***ridiculed*** by many tax experts. "***It is like two families trying to claim the same child as a dependent,***" says Sheldon D. Pollack, a professor of accounting at the University of Delaware who is an expert in corporate tax shelters.
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> * * *
>
> The key ingredient to the transaction was a pool of mortgage-backed securities owned by Bankers Trust that had lost money -- and therefore could be cashed in for tax deductions. BT transferred these securities, known as REMICs, to a new partnership known as ECT Investing Partners that it jointly owned with Enron. For its part, Enron tossed in some cash and other stray assets such as airplane leases. When these maneuvers were complete, both BT and Enron had rights to the deductions for the REMICs.
>
> Neat trick. ***This would normally be illegal*** because the Internal Revenue Code prohibits one company (Enron, in this case) from buying another outfit (ECT) simply to acquire its deductions. ***To get around this rule, Enron claimed that it had a legitimate business purpose for the deal other than tax avoidance. And what was that? Believe it or not, to inflate earnings*** -- or, as Akin Gump put it in the firm's opinion letter, to "obtain financial income" benefits from the deal. Both Enron bankruptcy examiner Neal Batson and the Joint Committee on Taxation have criticized this legal alchemy.

256.14 Through this fraudulent device, Enron generated approximately $65 million in net earnings for financial reporting purposes from 97-01 plus approximately $112 million in net federal income tax deductions from 97-01.[7] Not only did the idea originate with Bankers Trust, but Bankers Trust provided Enron with documentation regarding the accounting treatment of Project Steele. For its role in perpetrating the fraud, Bankers Trust was to earn a $10 million fee (and had collected $8.65 million prior to Enron filing for bankruptcy).

256.15 Not only did Bankers Trust clearly know that a huge portion of Enron's reported financial income was from an undisclosed taxation scheme and not from ordinary business operations, but Bankers Trust knew Project Steele was illegal and fraudulent. Project Steele

[7] The $112 million tax savings figure differs from that provided in the chart at ¶256.10. The $112 million figure is based upon a 1/31/03 letter from Skadden, Arps (Enron's legal counsel) to Lindy L. Paull of the Joint Committee on Taxation. The $39 million number is based upon calculations made by the Joint Committee itself in the Joint Committee Report at 107.

included an "unusual provision nullifying the deal" if it had to be disclosed. The obvious reason for such a clause, which *BusinessWeek* articulated in its 3/31/03 article concerning Bankers Trust's fraudulent tax schemes, is that "if the IRS found out about the dubious shelter [Bankers Trust] had proposed, ***it would almost certainly challenge the transaction***." Bankers Trust clearly understood at the time it implemented Project Steele that the fraudulent scheme could not withstand legitimate scrutiny and, therefore, knew (or recklessly disregarded) that Enron's publicly disclosed financial results were false.

Project Teresa

256.16 Like Project Steele, Project Teresa was pitched to Enron by Bankers Trust in 97. Defendant Rice was the initial contact. Also like Project Steele, Teresa took place in 97 but artificially inflated Enron's earnings over a period of years. Teresa was designed to raise the value of Enron's investment in its Houston headquarters by $1 billion while simultaneously reducing its investment in Enron Liquids preferred stock, which had the effect of increasing the tax basis of a depreciable asset and reducing the tax basis of a nondepreciable asset. This purportedly enabled Enron to take greater write-offs for the depreciation of its office building in future years (starting in 2003). However, Enron accounted for these future write-offs as present income.

256.17 In the words of the Joint Committee Report:

> Project Teresa was a synthetic lease arrangement designed to result in an increase in tax basis in depreciable assets (the most significant asset being the Enron North office building) with minimal economic outlay. This was accomplished in the following manner: Enron, through a deconsolidated entity, contributed depreciable assets and preferred stock of an affiliate to a partnership. Bankers Trust (the promoter of the transaction) contributed cash to the partnership. Enron affiliates would periodically acquire (or redeem) the preferred stock from the partnership, with the acquisition/redemption being treated as a taxable dividend eligible for an 80 percent dividends received deduction. Enron's basis in its partnership interest was increased by the total amount of the dividend (without regard to the dividends received deduction). Ultimately, the partnership was to be liquidated in a manner that would result in Enron receiving the depreciable assets with the increased basis. Enron would recover this increased tax basis through higher future depreciation deductions on the Enron North office building and the other depreciable assets.

256.18 Through this deceptive device, Enron and Bankers Trust artificially inflated Enron's financial statement earnings in excess of $226 million during the period 97-01. For its part, Bankers Trust "earned" an $11 million fee – paid out through 01.

256.19 There is no doubt that both Bankers Trust and Enron were acting to artificially inflate Enron's reported financial results, and in violation of tax code requirement that transactions have a legitimate business purpose other than tax savings. Indeed, the tax opinion prepared by the law firm King & Spalding states: "'The predominant purpose of Enron and its Affiliates for participating in [the redemption transaction in Project Teresa] was to generate income for financial accounting purposes.'"

Project Cochise

256.20 Project Cochise, a variation of Project Steele, was – according to the Joint Committee Report – "intended to yield Enron a combination of both income for financial statement purposes and deductions for Federal income tax purposes." Project Cochise was begun in 7/98, and Bankers Trust delivered an engagement letter on 1/29/99 by which it was to be the exclusive financial advisor to Enron on this transaction. For its part, Bankers Trust was to "earn" $15 million in fees, starting in 9/99 and lasting through 12/1/02 (coincidently mirroring the end of the Class Period).

256.21 Project Cochise was a variation of the earlier tax scheme, Project Steele. Like Steele, Cochise also involved the transfer of REMIC (*i.e.*, mortgage-backed securities) and other assets from Bankers Trust to an Enron affiliate, whereby both Enron and Bankers Trust sheltered taxable income with the tax deductions resulting from the losses suffered by these mortgage backed securities.

256.22 Through this deceptive device, Enron and Bankers Trust artificially inflated Enron's financial statement earnings by $101 million during the period 99-01. In response to questions posed by Congressional investigators, Enron has admitted it recorded financial statement benefits from Project Cochise of $27.7 million in 99, $50.3 million in 00 and $23.2 million in 01.

256.23 There is no doubt that both Bankers Trust and Enron were acting to artificially inflate Enron's reported financial results, and in violation of tax code requirement that transactions have a legitimate business purpose other than tax savings. Indeed, the tax opinion prepared by McKee Nelson Ernst & Young LLP states that the "'most important purposes of members of the Enron Affiliated Group for participating in [the Cochise Transaction]'" included "'increas[ing] the pre-tax financial accounting income and the net earnings on the Enron consolidated financial statements as a result of the Transactions.'"

Project Tomas

256.24 On 9/15/98, Bankers Trust signed an engagement letter agreeing to be Enron's exclusive financial advisor for Project Tomas, by which Enron (through an affiliate) and Bankers Trust agreed to enter into a partnership. The letter established that Bankers Trust would be paid $10 million in fees, plus additional amounts for certain services not included in the $10 million base. In the end, Bankers Trust was paid $11.875 million for its primary role in this fraudulent transaction.

256.25 Project Tomas was structured to increase the tax basis of a portfolio of leased assets that Enron liquidated. The increased basis of the assets eliminated approximately $270 million of taxable gain for Enron on the disposition of the property. The transaction involved the assumption, and repayment, of debt to increase the basis of the assets without an economic outlay. Bankers Trust made this possible by forming a partnership with an Enron subsidiary and contributing, along with Enron, other assets to the partnership which resulted in the basis of certain assets being duplicated and then shifted to the leased assets.

256.26 In short, through Project Tomas, Enron and Bankers Trust sold Enron assets that had appreciated without paying taxes on that appreciation – and booked earnings in the process. All by shuffling assets and debt around in a maze of transactions that served no other purpose but to defraud investors and the Internal Revenue Service.

256.27 Like in each of the other fraudulent transactions, Bankers Trust was an essential and primary actor in the Project Tomas fraud. As stated by the Joint Committee Report: "To dispose of the leased assets with a stepped-up basis without incurring tax, Enron formed a partnership with Bankers Trust, which in essence served as an accommodation party in the transaction. Without a willing though unrelated third party to hold the leased assets through a partnership for at least two years before selling them off, the tax savings and financial statement benefits claimed through the use of this structure would not have been possible."

256.28 Enron, through its legal counsel, represented to Congressional investigators that it reported financial statement benefits from Project Tomas of $18.1 million in 98 and $18.4 million in 00. The Joint Committee Report, however, estimates that Enron's financial statements included income from Project Tomas of $55.99 million in 98, $9.85 million in 99 and $51.29 million in 00.

In addition to this income recognized from Project Tomas, the transaction also provided Enron with $95 million in tax savings in 98-01.

256.29 There is no doubt that both Bankers Trust and Enron were acting to artificially inflate Enron's reported financial results. Indeed, the tax opinion prepared by the law firm Akin, Gump, Strauss, Hauer & Feld states that the Enron affiliate in the transaction "expects certain financial accounting benefits to be recognized on the consolidated GAAP financial statement in which it is included."

Projects Renegade and Valhalla

256.30 Projects Renegade and Valhalla were fraudulent tax schemes of a different kind, from the perspective of Enron's role. Rather than being designed so that Enron could fraudulently achieve favorable tax benefits and earnings income, Projects Renegade and Valhalla were designed to enable Bankers Trust to achieve favorable tax benefits through sham transactions with Enron. For acting as the "other" party to these sham transactions for the benefit of Bankers Trust, Enron received millions of dollars in fees. Enron received approximately $17 million for its illegal and fraudulent actions in Projects Renegade and Valhalla, which went directly to its bottom-line; the bulk of it ($16 million) artificially inflating Enron's 00 and 01 financial statements. In both Projects Renegade and Valhalla, Enron's role was that of an accommodation party (a strawman that acted not independently but to facilitate the transaction for the benefit of Bankers Trust).

256.31 In 12/98, Bankers Trust promoted the concept of Project Renegade to Enron. Renegade involved a complicated and circular series of transactions by which Bankers Trust loaned $320 million to an Enron subsidiary, ECT Equity Corporation, and then ECT contributed the bulk of that money to its subsidiary, Wiltshire Financial Assets, LLC, and then Wiltshire paid off Bankers Trust's original loan. The transactions were nearly perfectly circular, but for an $8 million loan remaining from Bankers Trust to Enron and substantial tax advantages to Bankers Trust arising from the exploitation of tax rules concerning financial asset securitization investment trusts. For its part, Enron received a million dollar fee that it used to artificially inflate its earnings and – more importantly – Enron was able to further reward Bankers Trust/Deutsche Bank for being its partner in the fraudulent tax schemes detailed above.

256.32 Like Renegade, Project Valhalla resulted in earnings and substantial tax benefits to Deutsche Bank, which paid substantial fees to Enron for its involvement. Indeed, Enron's fees were based upon the amount of benefit to Deutsche Bank. In effect, Project Valhalla took advantage of differing tax treatment under German and U.S laws. Put simply, Deutsche Bank received a stream of income from Enron that was not taxable under German law, but Deutsche Bank financed this income stream by making payments to Enron for which it took tax deductions on the interest portion under U.S. tax laws. For its part in this fraudulent transaction, Enron "earned" and artificially inflated its reported net income by $7 million in 00 and $9 million in the first three quarters of 01. Recognizing that the transaction would likely draw fire from regulators if it were exposed in Enron's bankruptcy, Deutsche Bank substantially ended the arrangement shortly before Enron filed for bankruptcy protection.

INVOLVEMENT OF VINSON & ELKINS

257. Vinson & Elkins was general corporate counsel to Enron for many years and throughout the Class Period. Enron was Vinson & Elkins' largest client. Vinson & Elkins participated in the negotiations for, prepared the transaction documents for, and structured Enron's and Chewco/JEDI partnership and virtually all of the related SPE entities and transactions – manipulative devices which falsified Enron's reported profits and financial condition. These manipulations resulted in Enron's massive restatement in 11/01 and collapse into bankruptcy shortly thereafter. Vinson & Elkins knew that these partnership entities and SPE entities were ***not*** independent of Enron and were ***not*** valid SPEs, but rather, were manipulative contrivances being utilized to artificially inflate Enron's reported financial results. Nevertheless, Vinson & Elkins repeatedly gave "true sale" and other opinions that were false – but were indispensable for those deals to "close," *i.e.*, take place, and the fraudulent scheme to continue. Vinson & Elkins also drafted and/or approved the adequacy of Enron's press releases, shareholder reports and SEC filings (including Form 10-Ks and Registration Statements alleged in this Complaint which Vinson & Elkins knew were false and misleading). Vinson & Elkins also wrote the disclosures regarding the related party transactions, which Vinson & Elkins knew were misleading and concealed material facts concerning those transactions. Finally, during the summer and fall of 01, Vinson & Elkins also

engaged and participated in covering up the fraudulent scheme and wrongful course of business by conducting a whitewash investigation of what it knew were correct allegations of fraudulent misconduct – which Vinson & Elkins had itself been involved in.

258. Vinson & Elkins' involvement in and knowledge of Enron's manipulative off-balance-sheet transactions was extraordinarily extensive. Vinson & Elkins provided advice in structuring virtually every one of Enron's off-balance-sheet transactions and prepared the transaction documents (including opinions) for deals involving at least the following entities:

JEDI	Delta
JEDI/Big River/Little River	Roosevelt
JEDI/Condor	
JEDI/Osprey/Whitewing/Condor	
JEDI/Whitewing	
JEDI II	
JEDI II/Ontario	

A. Vinson & Elkins' Role in the SPEs

259. Vinson & Elkins knew that Enron was using phony SPEs to inflate the Company's financial statements because of its role in the formation of, and transactions with, each of those entities. For example, Vinson & Elkins was intimately involved in the last-minute formation of Chewco at year-end 97.

260. By forming Chewco at year-end 97, Enron and Vinson & Elkins avoided a disaster by keeping Enron's previously recorded profits from transactions with JEDI in place, thus inflating Enron's 97 reported profits. ***Thus, Chewco/JEDI was not a valid SPE meeting the requirements for non-consolidation. Notwithstanding this, Enron did not consolidate Chewco/JEDI into Enron's financial statements during 97 and used Chewco/JEDI to generate false profits from 97 and beyond***, in transactions that Vinson & Elkins participated in structuring and provided false "true sale" opinions to facilitate. Chewco was now also positioned to serve as a controlled entity which Enron could use going forward with which to do non-arm's-length transactions, which Vinson & Elkins would give "true sale" opinions on and would create phony profits for Enron (at least $350 million) and allow Enron to conceal the true state of its indebtedness by improperly moving debt off its balance sheet and onto the books of Chewco.

261. Vinson & Elkins prepared the documentation for Chewco's financing and ***falsified*** these documents so as to make it appear that Chewco was independent. For non-consolidation, Chewco had to be funded by at least 3% equity from independent investors. With just one day left in 97, Vinson & Elkins drafted a side agreement providing that ***Enron would provide the necessary $6.6 million in cash to fund Chewco via clandestine reserve accounts for Big River Funding and Little River Funding***. The side agreement was dated 12/30/97. The Kopper/Enron side agreement concocted by Vinson & Elkins made it clear that ***no outside equity was used to fund Chewco and thus Chewco was not a viable SPE.*** Rather, Chewco was simply a manipulative device and artifice to further a fraud and which served to falsely inflate Enron's financial statements.

262. Vinson & Elkins also took steps to avoid disclosure of the Chewco buyout of the partner interest in JEDI and Enron's control of JEDI. Initially, Fastow was to have managerial control of Chewco, but the participants realized that Fastow could not have that position without having to disclose this interest in Enron's SEC filings. This would potentially expose the non-arm's-length of this transaction. So Vinson & Elkins and Fastow arranged for Kopper, Fastow's subordinate, to be substituted as the manager of Chewco, and by this subterfuge conceal this from Enron's shareholders.

263. During 12/97, Vinson & Elkins also made changes to the structure of the transaction to allow Enron to avoid disclosing the existence of Enron's financial relationship with Chewco. Vinson & Elkins converted the General Partner of Chewco from a limited liability company to a limited partnership, and put Kopper in instead of Fastow as the owner of Chewco's general partner. The sole purpose for this structural change was to allow non-disclosure of the Chewco/JEDI transactions at year-end 97. However, prior to the closing of Chewco, Kopper expressed concern over his improper conflict of interest since he was an Enron employee and would act as the owner of both the general partner of Chewco ***and*** the owner of the equity of limited partner, Big River Funding. Notwithstanding the fact Kopper complained to Vinson & Elkins about the sham transaction, they went ahead and structured the transaction as proposed. Vinson & Elkins did not withdraw from its involvement in the scheme or insisted on disclosure of this conflict of interest in Enron's SEC filings – despite this clear red flag of its impropriety.

B. Vinson & Elkins' False and Misleading "Disclosures" Concerning JEDI/Chewco

264. In Enron's Reports on Form 10-K for the years ended 97 through 00, Vinson & Elkins approved JEDI's description as an unconsolidated affiliate purportedly only "50 percent" owned by Enron. In Enron's Report on Form 10-K filed 3/30/00, Vinson & Elkins drafted and approved as adequate disclosure the following: "At December 31, 1999, JEDI held approximately 12 million shares of Enron Corp. common stock. The value of the Enron Corp. common stock has been hedged. In addition, an officer of Enron has invested in the limited partner of JEDI and from time to time acts as agent on behalf of the limited partner's management." Those "disclosures" were false and misleading. The existence of Chewco, that Chewco was not independent, was not capitalized with outside equity at risk but instead was capitalized by JEDI and an Enron guaranty, or that Chewco was a limited partner of JEDI was never disclosed until Enron announced its massive restatement on 11/8/01. Nor was it disclosed that JEDI transactions were ***not*** true commercial, economic transactions, comparable to transactions with independent third parties. Nor was the substance and effect of the JEDI transactions on Enron and the Company's financial statements disclosed.

C. The Attempted Coverup

265. In mid-8/01, just as Skilling resigned as Enron's CEO, a management level Enron employee (Watkins) sent Lay a letter detailing the huge fraud at Enron – focusing on the bogus partnerships and SPE transactions. Her letter stated:

Dear Mr. Lay,

* * *

> Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.
>
> The spotlight will be on us, the market just can't accept that Skilling is leaving his dream job.... How do we fix the Raptor and Condor deals?... [W]e will have to pony up Enron stock and that won't go unnoticed.

* * *

> We have recognized over $550 million of fair value gains on stocks via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm. The New Power Co. by 70%, from $20/share to $6/share. The

value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.

I am incredibly nervous that we will implode in a wave of accounting scandals.... [T]he business world will consider the past successes as nothing but an elaborate accounting hoax. Skilling is resigning now for "personal reasons" but I think he wasn't having fun, looked down the road and knew this stuff was unfixable and would rather abandon ship now than resign in shame in 2 years.

Is there a way our accounting guru's can unwind these deals now? I have thought and thought about how to do this, but I keep bumping into one big problem – ***we booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse.*** We are under too much scrutiny and there are probably one or two disgruntled "redeployed" employees who know enough about the "funny" accounting to get us in trouble.

* * *

I realize that we have had a lot of smart people looking at this .... ***None of that will protect Enron if these transactions are ever disclosed in the bright light of day.***

* * *

My concern is that the footnotes don't adequately explain the transactions. If adequately explained, the investor would know that the "Entities" described in our related party footnote are thinly capitalized, the equity holders have no skin in the game, and all the value in the entities comes from the underlying value of the derivatives (unfortunately in this case, a big loss) AND Enron stock and N/P. ***Looking at the stock we swapped, I also don't believe any other company would have entered into the equity derivative transactions with us at the same prices or without substantial premiums from Enron.***

* * *

Raptor looks to be a big bet, if the underlying stocks did well, then no one would be the wiser. If Enron stock did well, the stock issuance to these entities would decline and the transactions would be less noticeable. ***All has gone against us. The stocks, most notably Hanover, The New Power Co., and Avici are underwater to great or lesser degrees.***

* * *

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

Summary of Raptor Oddities:

* * *

2. ***The equity derivative transactions do not appear to be at arms length.***

a. Enron hedged New Power, Hanover, and Avici with the related party at what now appears to be the peak of the market. New Power and Avici have fallen away significantly since. The related party was unable to lay off this risk. This fact pattern is once again very negative for Enron.

b. ***I don't think any other unrelated company would have entered into these transactions at these prices.*** What else is going on here? What was the compensation to the related party to induce it to enter into such transactions?

3. ***There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly.*** This alone is cause for concern.

a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. ***He complained mightily to Jeff Skilling*** .... 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets ....

b. ***Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM.***

c. I have heard one manager level employee ... say "***I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company."... Many similar comments are made when you ask about these deals.***

266. Watkins' letter made clear that Vinson & Elkins had been involved in the fraud and had a clear conflict of interest. Nevertheless, Lay promptly contacted top Vinson & Elkins partners to find out how to cover up these allegations.

267. Vinson & Elkins, despite its clear conflict, agreed with Enron to conduct a "purported" investigation into these charges and to issue a letter or a report dismissing the allegations of fraud – which they knew to be true. Vinson & Elkins and Enron agreed the firm would not "second-guess" accounting work or judgments of Andersen and Vinson & Elkins would limit its inquiry to top level executives at Enron, *i.e.*, the persons on the fraud.

268. The result of this letter – laying out another massive area of fraudulent misconduct at Enron – was an explosion.

269. Between 8/15-10/15/01, Vinson & Elkins conducted a purported investigation of the assertions of wrongdoing. Vinson & Elkins interviewed several top level Enron executives who had been involved, but only interviewed people who it knew were involved in the fraud and thus would deny it. On 10/15/01, Vinson & Elkins issued a letter to Enron which basically dismissed ***all*** of

Watkins' assertions even though Vinson & Elkins, from its own involvement in the fraud, knew they were true. Vinson & Elkins' 10/15/01 letter belittled and trivialized the assertions – constantly referring to them as coming from an anonymous source – even though Vinson & Elkins well knew who Watkins was and that she was in a position to know what she was asserting.

> You requested that Vinson & Elkins L.L.P. ("V&E") conduct an investigation into certain allegations initially made on an ***anonymous*** basis by an employee of Enron Corp. ("Enron"). Those allegations question the propriety of Enron's accounting treatment and public disclosures for certain deconsolidated entities known as Condor or Whitewing and certain transactions with a related party, LJM, and particularly transactions with LJM known as Raptor vehicles. The anonymous employee later identified herself as Sherron Watkins, who met with Kenneth L. Lay, Chairman and Chief Executive Officer of Enron, for approximately one hour to express her concerns and provided him with materials to supplement her initial anonymous letter....
>
> * * *
>
> ***Based on the findings and conclusions set forth with respect to each of the four areas of primary concern discussed above, the facts disclosed through our preliminary investigation do not, in our judgment, warrant a further widespread investigation by independent counsel and auditors....***
>
> ***... Finally, we believe that some response should be provided to Ms. Watkins to assure her that her concerns were thoroughly reviewed, analyzed, and although found not to raise new or undisclosed information, were given serious consideration.***
>
> We have previously reported verbally to Mr. Lay and you regarding our investigation and conclusions and, at your request, have reported the same information to Robert K. Jaedicke, in his capacity of Chairman of the Audit Committee of Enron's Board of Directors. At Dr. Jaedicke's request, we gave a verbal summary of our review and conclusions to the full Audit Committee.

270. When Lay wanted to fire Watkins for her letter, Vinson & Elkins and Lay agreed that this would be a mistake and would lead to a wrongful termination suit exposing what Watkins had alleged about the transactions at Enron. So Vinson & Elkins and Enron agreed that Watkins should be shifted to another job at Enron where she would have less access to damaging information.

¶¶271-285 Deleted.

INVOLVEMENT OF ARTHUR ANDERSEN

A. General

286. Andersen, a worldwide firm of certified public accountants, was involved in every facet of Enron's business. Andersen audited Enron's financial statements, it acted as internal auditors

for Enron, it prepared Enron's tax returns, it provided consulting services on a wide range of topics and consulted on the accounting for the very transactions at issue in this litigation throughout the Class Period. Andersen examined and opined on Enron's financial statements for 96 and 97, and reviewed Enron's interim 96 through 97 results and press releases. As a result of the far-reaching scope of services provided by Andersen, it was intimately familiar with Enron's business affairs and its personnel were present at Enron's Houston headquarters on a year-round basis. Andersen's Houston and Chicago offices were routinely involved in the development, consulting and accounting for the fraudulent deals and transactions at issue herein.

287. Andersen, as Enron's independent auditor, had a unique role and responsibility. Since 34, when Congress passed a law requiring that publicly traded companies have their books audited annually by independent accountants, auditors have been the investing public's watch dog. Indeed, the United States Supreme Court affirmed that responsibility:

> By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

United States v. Arthur Young & Co., 465 U.S. 805, 817-18 (1984). Andersen however, turned its back on its responsibilities to Enron's investors and the investing public, and abandoned its professional standards by helping Enron perpetrate the massive accounting fraud as alleged herein.

288. Andersen falsely represented that Enron's financial statements for 96 and 97 presented in accordance with GAAP and that Andersen's audits of Enron's financial statements had been performed in accordance with GAAS. Andersen also consented to the incorporation of its reports on Enron's financial statements in Enron's Form 10-Ks for those years and in Enron's Registration Statements for the Company's: (i) registration of $1 billion in Enron Debt Securities, Warrants, Preferred Stock and Depository Shares filed on 12/17/97; (ii) registration of 488,566 shares of common stock filed on 1/12/98; and (iii) registration of 34.5 million shares of common stock filed on 4/21/98. Andersen's issuance of, and multiple consents to reissue, materially false reports on Enron's 97-98 financial statements were themselves violations of GAAS.

289. The SEC has stressed the importance of meaningful audits being performed by independent accountants:

> [T]he capital formation process depends in large part on the confidence of investors in financial reporting. An investor's willingness to commit his capital to an impersonal market is dependent on the availability of accurate, material and timely information regarding the corporations in which he has invested or proposes to invest. The quality of information disseminated in the securities markets and the continuing conviction of individual investors that such information is reliable are thus key to the formation and effective allocation of capital. ***Accordingly, the audit function must be meaningfully performed and the accountants' independence not compromised.***

Relationship Between Registrants and Independent Accountants, SEC Accounting Series Release No. 296, 1981 SEC LEXIS 858, at *8-*9 (Aug. 20, 1981).

290. GAAS, as approved and adopted by the AICPA, are measures of the quality of the performance of audit procedures, the professional qualities the auditor should possess, and the judgment exercised by the auditor in the performance of the audit and issuance of his or her report. Statements on Auditing Standards ("SAS") (codified and referred to as AU §___) are recognized by the AICPA as the interpretation of GAAS.

291. With respect to Enron's financial statements for 97, Andersen represented, in a report dated 2/23/98, the following:

> REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS
>
> To the Shareholders and Board of Directors of Enron Corp.:
>
> We have audited the accompanying consolidated balance sheet of Enron Corp. (an Oregon corporation) and subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of Enron Corp.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries as of

December 31, 1997 and 1996, and the results of their operations, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 1997, in conformity with accounting principles generally accepted in the United States.

292. Andersen issued nearly identical audit reports for 96.

293. Andersen's reports were false and misleading due to its failure to conduct its audits in compliance with GAAS and because Enron's financial statements were not prepared in conformity with GAAP, as alleged in detail in ¶¶106-168, so that issuing the reports was in violation of GAAS and SEC rules. Andersen knew its reports would be relied upon by present and potential investors in Enron securities. Throughout the same period Andersen performed reviews of Enron's quarterly financial statements, reviewed and approved Enron's quarterly reports filed on Forms 10-Q and reviewed, discussed and approved Enron's press releases.

B. Andersen Was Not Independent

294. Enron was Andersen's crown jewel client. Enron was the firm's second largest single client and its relationship with Enron was extremely lucrative and was expected to become even more so in the near future. By 00, Andersen would receive $52 million in fees for services it provided to Enron, of which $25 million related to the audit fees and another $27 million related to its highly-profitable consulting work. This was an incredible level of fees, even for one of the largest accounting firms in the world. These fees were particularly important to Andersen's partners as their incomes were dependent on the continued business from Enron. Eventually, Andersen's Houston office alone had at least eight partners working on Enron engagements, five of which were assigned to Enron full time, as well as at least 100 additional professionals. Numerous Houston Andersen auditors worked solely on Enron engagements. Andersen's Gulf Coast Market partners had a particular incentive and were under enormous pressure to not only retain Enron, but to increase the billings to the client which already accounted for a large portion of the Houston office total revenue. Andersen partners assigned to the Enron account held regular "Client Service Team" meetings during the Class Period to discuss ways to sell more services and bill more fees to Enron.

295. Professional Audit Standards promulgated by both the AICPA and the SEC require that auditors be independent, objective and free of conflicts of interest. *See* ET§54, 55, 102.

296. Andersen violated these professional standards and others as alleged at ¶¶319-321, and breached its duty to the public trust when its thirst for fees caused it to assist Enron in Enron's improper accounting as outlined below.

C. Andersen's Conflicts of Interest

297. Andersen knew that the key to increasing its fees was to help Enron maintain its undeserved investment-grade credit rating as it grew. Enron set up outside entities with joint investors that would hold assets and the debt Enron was incurring to finance them. Andersen and the Enron Defendants knew however, that if Enron retained effective control over the joint entity, GAAP required consolidation of the investment in its entirety (the inclusion of all assets, liabilities and losses) into Enron's consolidated financial statements. Determined to earn the enormous fees associated with this guidance, Andersen abandoned its professional duty to remain independent, objective and skeptical, and did not require revision of an accounting treatment it had approved, even when Enron and its lawyers and bankers structured more and more egregious transactions. The effort put forth by Andersen included the consultation and involvement of partners at the highest level of Andersen, including top partners at Andersen's national office headquartered in Chicago.

298. In this collaboration with Enron, its lawyers and bankers, Andersen violated the profession's fundamental principles of objectivity, skepticism, independence and integrity required by GAAS. As an auditor, Andersen's job was not to find a way to justify spurious accounting treatment that a layman would intuitively recognize as a ruse.

D. Andersen Disregarded Major Indicators of Financial Statement Fraud at Enron ("Red Flags")

(1) Andersen Knew the Risk of Fraud Was Extremely High

299. Andersen had direct knowledge of Enron's improper accounting as alleged herein. Andersen also knew that the risk of fraudulent financial reporting at Enron was very high. In designing and carrying out audit procedures, professional standards specifically require that auditors assess the risk of material misstatement due to fraud. To that end, Andersen, pursuant to SAS No. 82 (AU §§316, 110), was required to assess the risk of fraudulent financial statements at Enron. Andersen had a "responsibility to plan and perform the audit to obtain reasonable assurance about

whether the financial statements are free of material misstatement, whether caused by error or fraud," AU §110, and plan an audit to increase the likelihood that fraud will be discovered. AU §316 provides categories of fraud risk factors that should be considered in making that assessment. Andersen knew that Enron possessed many of the risk factors delineated in AU §316.16-.18, including:

> ***Risk factors relating to operating characteristics and financial stability.***
>
> - Overly complex organizational structure involving numerous or unusual legal entities, managerial lines of authority, or contractual arrangements without apparent business purpose.
> - Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
> - Significant, unusual, or highly complex transactions, especially those close to year end, that pose difficult "substance over form" questions.
> - Significant bank accounts or subsidiary or branch operations in tax haven jurisdictions for which there appears to be no clear business justification.

300. Andersen knew that Enron had an extraordinarily complex structure. Andersen helped Enron structure hundreds of highly complex partnerships many of which had no apparent business purpose other than to conceal debt and losses. Moreover, Enron's related-party transactions were massive. The true "substance" of many of these related-party transactions was that Enron maintained control over entities but improperly did not consolidate them. Further, Andersen knew that Enron used hundreds of offshore tax haven entities to shift income, minimize taxation, circumvent laws in the United States, and maintain secrecy. Andersen even knew that many of the Fastow controlled partnerships were formed in offshore havens. Andersen, including its tax and consulting departments, knew about the excessive use of such entities and knew that no clear business justification existed for many of them. Other risk factors included:

> ***Risk factors relating to management's characteristics and influence over the control environment.***
>
> – Management failing to correct known reportable conditions on a timely basis.
>
> – Management setting unduly aggressive financial targets and expectations for operating personnel.
>
> – A significant portion of management's compensation represented by bonuses, stock options, or other incentives, the value of which is contingent upon the

entity achieving unduly aggressive targets for operating results, financial position, or cash flow.

- An excessive interest by management in maintaining or increasing the entity's stock price or earnings trend through the use of unusually aggressive accounting practices.

- A practice by management of committing to analysts, creditors, and other third parties to achieve what appear to be unduly aggressive or clearly unrealistic forecasts.

AU §316.17(a).

301. Andersen knew that Enron management had not only an "excessive interest" but a highly unusual interest in maintaining the Company's stock price. In fact, Enron was recognizing, with Andersen's knowledge, income from the inflation of its own stock price. Enron's hedges were dependent on maintaining its stock price. Insider trading proceeds were a huge part of management's income. In addition, Enron executives received multi-millions of dollars in bonuses from hitting a series of stock-price targets based on a program known as the "Performance Unit Plan." Highly "aggressive targets" were the definition of Enron's business and management practices. Andersen knew that Enron had failed to make some $51 million in proposed audit adjustments in 97 as alleged at ¶¶138 and 311. Other risk factors included:

- Unusually rapid growth or profitability, especially compared with that of other companies in the same industry.

- Significant pressure to obtain additional capital necessary to stay competitive considering the financial position of the entity–including need for funds to finance major research and development or capital expenditures.

AU §316.17(c).

302. As depicted in the following chart, Enron experienced dramatic growth between 95 and 97. Note the following:

	1995	**1996**	**1997**
Net Sales	$9.2B	$13.3B	$20.3B

303. As a result of the extensive audit, review, tax, internal control and other consulting services it rendered to Enron, Andersen knew that these and nearly every other fraud risk factor identified by AU §316 above applied to Enron's situation during the Class Period. As a

consequence, Andersen also knew that these risk factors present at Enron, taken collectively, meant that the risk of fraudulent financial reporting was extremely high.

E. Andersen Knew Enron Improperly Hid Debt and Boosted Reported Income Through Use of the SPEs

304. The Enron Defendants, with Andersen's and Enron's lawyers' and bankers' participation, embarked on a scheme of structuring and accounting that allowed Enron to keep debt off its books and, at the same time, record income from and maintain control over the entities involved in the deal. Andersen and the Enron Defendants knew, however, that if Enron retained effective control over the joint entity, GAAP required consolidation of the investment in its entirety (the inclusion of all assets, liabilities and losses) into Enron's consolidated financial statements.

305. As one of the largest audit firms in the world, Andersen was well aware of the strategies, methods and procedures required by GAAS to conduct a proper audit. Additionally, Andersen knew of the audit risks inherent at Enron and in the industries in which Enron operated because of the comprehensive services it provided to Enron over the years and its experience with many other clients. To fully comprehend the extent of Andersen's involvement in the structuring, accounting, and activities of Enron's SPEs, it is important to view the transactions in light of the fact that Andersen billed Enron millions of dollars for the advice it provided on the Chewco entities. The accounting decisions relating to the SPEs were made at the highest levels of Andersen. Enron communicated not only with the Houston partners including (Duncan) but also with Andersen's National Office Group ("NOG") and professional services group in Chicago. A former Enron tax manager related that Enron's internal policies on whether certain SPEs would be consolidated on Enron's books were driven by Andersen and, whenever anyone at Enron had a question about how to structure a deal, the question was taken to Andersen engagement partner David Duncan, who then consulted with the Chicago office. Additional evidence of Andersen's failure to comply with GAAS in the performance of the Enron audits is noted in the following paragraphs.

306. The Chewco and JEDI relationships were transactions which Andersen was required to carefully evaluate. Pursuant to AU §334.09:

> .09 After identifying related party transactions, the auditor should apply the procedures he considers necessary to obtain satisfaction concerning the purpose,

nature, and extent of these transactions and their effect on the financial statements. The procedures should be directed toward obtaining and evaluating sufficient competent evidential matter and should extend beyond inquiry of management. Procedures that should be considered include the following:

a. Obtain an understanding of the business purpose of the transaction.[8]

b. Examine invoices, executed copies of agreements, contracts, and other pertinent documents, such as receiving reports and shipping documents.

c. Determine whether the transaction has been approved by the board of directors or other appropriate officials.

d. Test for reasonableness the compilation of amounts to be disclosed, or considered for disclosure, in the financial statements.

e. Arrange for the audits of intercompany account balances to be performed as of concurrent dates, even if the fiscal years differ, and for the examination of specified, important, and representative related party transactions by the auditors for each of the parties, with appropriate exchange of relevant information.

f. Inspect or confirm and obtain satisfaction concerning the transferability and value of collateral.

307. Andersen ignored this professional literature, which required that Andersen understand the transactions and the business purpose for the transactions, and failed to insist that Enron make adequate disclosure and proper accounting for the transactions. Andersen knew that:

- Employees and officers of Enron had interests in and control over certain of the SPEs.
- The Barclays investment on the Chewco deal had a reserve of $6.6 million such that there was not 3% independent equity in the partnership and it was not a qualifying SPE.
- Andersen's extensive involvement with the JEDI and Chewco transactions is evidenced by the $5.7 million Andersen billed Enron for its work on those transactions.

(1) Red Flags Associated with JEDI/Chewco

308. The beginning of Enron's pervasive practice of not consolidating its joint investments can be traced back at least to 93, with the formation and capitalization of the JEDI joint venture.

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[8] Until the auditor understands the business sense of material transactions, he cannot complete his audit. If he lacks sufficient specialized knowledge to understand a particular transaction, he should consult with persons who do have the requisite knowledge.

Andersen provided audit and consulting services at the time, and was involved in the accounting for those transactions.

309. As described in ¶¶131-137, 225-226, Enron created the Chewco SPE with Barclays' help in late 97 for the purpose of buying out an institutional investor's 50% stake in JEDI so that JEDI could still ostensibly be considered independent. Significant red flags surrounded the creation of this SPE, raising significant questions regarding the substance or legitimate business purpose of the transaction. Andersen provided significant assistance in structuring and reviewing the transaction, and billed Enron $80,000 for its review of the Chewco deal. This amounted to approximately 400 hours of examination on Chewco (assuming an average hourly rate of $200 per hour) during a short period at the end of 97. During Andersen's examination, including its review of Enron's 11/97 and 12/97 board minutes, Andersen recognized or should have recognized that virtually every aspect of the deal carried a red flag that raised questions about Enron control, or the legitimacy of the business purpose and substance of the investment. For example, even on its face the details surrounding the formation of Chewco were red flags:

(a) Andersen knew that Chewco's general partners were senior financial employees at Enron;

(b) A 3% minimum of independent, at risk, controlling capital was not met, as Barclays required a reserve account deposit of $6.6 million to collateralize the loans. According to former Enron employees, Andersen was given documentation showing the reserve; and

(c) The Barclays funding to Chewco that purportedly made up the "equity part" of the investment actually was more like a loan.

310. In sum, as a result of Andersen's involvement in the creation and review of the Chewco deal, Andersen knew that practically every feature of Chewco's creation, funding, structure and wind-down raised red flags, yet Andersen ignored them. By ignoring these related-party connections and Enron's constructive control in the Chewco deal, Andersen helped Enron improperly keep the Chewco deal off the books. As a result, Andersen allowed Enron to improperly overstate profits by $405 million and understate debt by hundreds of millions of dollars.

F. $51 Million of Known Errors Ignored in the 97 Audit

311. During its audits of Enron's 97 financial statements, Andersen staff auditors compiled $51 million of adjustments where Enron's accounting was identified as improper. Andersen knew that these adjustments, taken collectively, amounted to almost 50% of Enron's $105 million net income for 97 and, as such, were clearly material to the financial statements and needed to be made in order for the financial statements to not be misleading. However, Enron told Andersen it did not want to make the adjustments, because the adjustments would dramatically reduce the $105 million in the net income figure Enron management was going to report to the public. As alleged above, because Enron was such a lucrative client, Andersen partners associated with the engagement acquiesced to Enron management and did not insist that the adjustments be made. In failing to do so, Andersen abandoned its role as the public watchdog and violated GAAS. However, due to the sheer size of the collective adjustments – almost 50% of Enron's net income, Andersen could not simply waive the adjustments in its workpapers without concocting some sort of justification. Andersen's obfuscation was as follows: In calculating whether $51 million in adjustments were material to the financial statements, it was obvious to Andersen that if it calculated the needed adjustment as a percentage of net income, as auditors universally do, the resulting answer of 50% of net income was clearly material. To divert attention from this reality, Andersen calculated the $51 million as a percentage of a contrived figure Andersen called "normalized earnings" instead of net income. By cooking up this supposed measure of materiality, Andersen improperly declared that because the $51 million adjustment was only 8% of "normalized earnings" (instead of a whopping 50% of net income) it was somehow immaterial and therefore no adjustment was necessary. By concocting a justification for waiving these necessary adjustments, Andersen demonstrated the depths it would sink to in order to please Enron management. In doing so, Andersen improperly allowed Enron to overstate income in 97 by $51 million.

312. Enron has now restated its financial statements for 97 through 00 and Andersen has stated that the audit reports covering the year-end financial statements for 97 through 00 "should not be relied upon." Unfortunately for the thousands of investors who had already relied upon

Andersen's reports, this warning came years too late, after they had lost billions of dollars based on admittedly false financial statements.

G. Andersen Knew Enron's Disclosures Were False

313. In accordance with GAAS, Andersen was required to consider whether Enron's disclosures accompanying its financial statements were adequate. SAS No. 32 as set forth in AU §431.02-.03 states:

> **.02** The presentation of financial statements in conformity with generally accepted accounting principles includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. An independent auditor considers whether a particular matter should be disclosed in light of the circumstances and facts of which he is aware at the time.
>
> **.03** If management omits from the financial statements, including the accompanying notes, information that is required by generally accepted accounting principles, the auditor should express a qualified or an adverse opinion and should provide the information in his report, if practicable, unless its omission from the auditor's report is recognized as appropriate by a specific Statement on Auditing Standards.

314. The required disclosures include those concerning related parties. Auditors are required to gather sufficient evidence to ensure they understand the relationship between parties and the effects of the transactions on the financial statements. The auditor should then satisfy himself that the transactions are adequately disclosed. AU §334.11 states:

> For each material related party transaction (or aggregation of similar transactions) or common ownership or management control relationship for which FASB Statement No. 57 [AC section R36] requires disclosure, the auditor should consider whether he has obtained sufficient competent evidential matter to understand the relationship of the parties and, for related party transactions, the effects of the transaction on the financial statements. He should then evaluate all the information available to him concerning the related party transaction or control relationship and satisfy himself on the basis of his professional judgment that it is adequately disclosed in the financial statements.

315. As detailed herein, Enron's disclosures with respect to its accounting practices and related parties were woefully inadequate. The Company failed to adequately disclose the transactions involving Chewco, the management involvement in LJM, the manipulative transactions involving the Raptors, the improper and abusive use of mark-to-market accounting, its improper use of its own stock to generate income, and the manipulative practices involving broadband and many

other accounting manipulations. Andersen actually knew about many of these issues as it had helped develop the accounting for them. Yet Andersen did not require notification of the disclosures and did not issue a qualified or adverse opinion on Enron's financial statements in violation of GAAS.

316. As *The Wall Street Journal* noted on 11/5/01:

> Questions could well turn to whether Andersen fulfilled its obligation to protect investors' interests. And an important focus is likely to be whether Andersen should have required Enron to better explain its dealings with partnerships run by former Chief Financial Officer Andrew S. Fastow before agreeing to bless the company's financial statements.
>
> * * *
>
> For its part, Enron – which is hardly the only large energy company with complex partnership dealings – maintains its off-balance-sheet transactions were legal and properly disclosed. "They comply with reporting requirements," says Enron spokeswoman Karen Denne, adding that Andersen was aware of the transactions and reviewed them.

317. Contrary to GAAP, Enron's disclosures were inadequate and contrary to GAAS, Andersen failed to require revision. As noted by *The New York Times* in 10/01, "Enron's disclosures have been widely criticized for being impossible to understand." These were the same disclosures with which Andersen had stated it was "very comfortable."

H. Andersen Violated Professional Standards

318. In addition to Andersen's improper departures from professional standards as particularized above, Andersen also violated the following professional standards among others.

319. The bylaws of AICPA require that members adhere to the Principles and Rules of the Code of Professional Conduct. Andersen violated those rules, including the following:

ET §53 – Article II – **The Public Interest**

> ***Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.***

ET §102 – **Integrity and Objectivity**

> **.02** ***Knowing misrepresentations in the preparation of financial statements or records.*** A member shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01] when he or she knowingly –
>
> *a.* Makes, or permits or directs another to make, materially false and misleading entries in an entity's

financial statements or records shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01]; or

ET §501 – **Acts Discreditable**

> **.05 501.4** – ***Negligence in the preparation of financial statements or records.*** A member shall be considered to have committed an act discreditable to the profession in violation of rule 501 [ET section 501.01] when, by virtue of his or her negligence, such member –
>
> *a.* Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or
>
> *b.* Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or
>
> *c.* Signs, or permits or directs another to sign, a document containing materially false and misleading information.

Additionally, AU §220 – Independence, further states that:

> **.01** The second general standard is:
>
> In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
>
> **.02** This standard requires that the auditor be independent; aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. However, independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors.

320. One of Andersen's responsibilities as Enron's independent auditor, was to obtain "[s]ufficient competent evidential matter ... to afford a reasonable basis for an opinion regarding the financial statements under audit" as to "the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles." AU §§150, 110. In violation of GAAS, and contrary to the representations in its report on Enron's financial statements, Andersen did not obtain sufficient, competent, evidential matter to support Enron's assertions regarding its income, assets, debt and shareholders'

equity for 97, 98, 99 and 00. Moreover, Andersen deliberately ignored information indicating that Enron's financial statements did not "present fairly" the Company's financial position.

321. Due to Andersen's false statements, knowledge of the improper accounting, failure to identify and modify its reports to identify Enron's false financial reporting, and lack of independence, Andersen violated the following GAAS standards:

(a) The first general standard is that the audit should be performed by persons having adequate technical training and proficiency as auditors.

(b) The second general standard is that the auditors should maintain an independence in mental attitude in all matters relating to the engagement.

(c) The third general standard is that due professional care is to be exercised in the performance of the audit and preparation of the report.

(d) The first standard of field work is that the audit is to be adequately planned and that assistants should be properly supervised.

(e) The second standard of field work is that the auditor should obtain a sufficient understanding of internal controls so as to plan the audit and determine the nature, timing and extent of tests to be performed.

(f) The third standard of field work is that sufficient, competent, evidential matter is to be obtained to afford a reasonable basis for an opinion on the financial statements under audit.

(g) The first standard of reporting is that the report state whether the financial statements are presented in accordance with GAAP.

(h) The second standard of reporting is that the report shall identify circumstances in which GAAP has not been consistently observed.

(i) The third standard of reporting is that informative disclosures are regarded as reasonably adequate unless otherwise stated in the report.

(j) The fourth standard of reporting is that the report shall contain an expression of opinion or the reasons why an opinion cannot be expressed.

FRAUD-ON-THE-MARKET

322. At all relevant times, the market for Enron's publicly traded securities was an efficient market for the following reasons, among others:

(a) Enron's securities were listed and actively traded on the NYSE and the Over-the-Counter Market which are efficient markets;

(b) As a regulated issuer, Enron filed periodic public reports with the SEC;

(c) Enron regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases, analyst conferences and conference calls; and

(d) Enron was followed by several securities analysts who wrote reports which were published, distributed and entered the public marketplace.

323. As a result of the foregoing, the market for Enron's publicly traded securities promptly digested current information regarding Enron from all publicly available sources and reflected such information in the price of Enron's securities. Under these circumstances, all purchasers of Enron's publicly traded securities during the Class Period suffered similar injury through their purchase of Enron's publicly traded securities at artificially inflated prices and a presumption of reliance applies.

STATUTORY SAFE HARBOR

324. The statutory safe harbor provided for forward-looking statements ("FLS") does not apply to the false FLS pleaded. The safe harbor does not apply to Enron's financial statements or results. Enron never gave any Safe Harbor warning in its conference calls during the Class Period. Enron's cautionary statements that were issued during the Class Period were not meaningful because the Enron Defendants each actually knew of the adverse condition of Enron's business and the problems in its business. The Enron Defendants are each liable for the false FLS pleaded because, at the time each FLS was made, the speaker actually knew the FLS was false and the FLS was authorized and/or approved by an executive officer of Enron who knew that the FLS was false.

CLASS ACTION ALLEGATIONS

325. Plaintiffs bring this action pursuant to Rule 23 of Federal Rules of Civil Procedure on behalf of all persons who acquired Enron's publicly traded securities (the "Publicly Traded

Securities") during the Class Period (the "Class"), including persons who purchased Enron securities traceable to false and misleading Registration Statements (the "Offering Subclasses") and Enron employees who purchased Enron stock individually or for their 401(k) retirement plans during the Class Period.[9] The Class includes purchasers of all securities identified herein issued by Enron-related entities during the Class Period, the value of repayment of which was dependent on the credit, financial condition or ability to pay of Enron. Excluded from the Class are the defendants and members of their immediate families, any officer, director or partner of any defendant, any entity in which a defendant has a controlling interest and the heirs of any such excluded party.

326. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown at the present time, as of 12/31/00, there were more than 750 million shares of common stock outstanding, more than 25 million shares of the Preferred Securities and billions of dollars of debt securities, owned by thousands of investors.

327. Plaintiffs' claims are typical of the claims of the Class because plaintiffs and all the Class members sustained damages which arose out of the defendants' unlawful conduct complained of herein.

328. Plaintiffs are representative parties who will fully and adequately protect the interests of the Class members. Plaintiffs have retained counsel who are experienced and competent in both class action and securities litigation. Plaintiffs have no interests which are in conflict with those of the Class they seek to represent.

329. A class action would be superior to all other available methods for the fair and efficient and adjudication of this controversy. Plaintiffs know of no difficulty to be encountered in the management of this action that would preclude its maintenance as a class action.

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[9] The Publicly Traded Securities include Enron's publicly traded debt and equity securities as well as preferred securities issued by Enron, Enron Capital LLC 8% Cumulative Guaranteed Monthly Income Preferred Shares, Enron Capital Trust I Trust Originated Preferred Securities, Enron Capital Trust II Trust Originated Preferred Securities and Enron Capital Resources, L.P. 9% Cumulative Preferred Securities (collectively, the "Preferred Securities").

330. The prosecution of separate actions by individual Class members would create a risk of inconsistent and varying adjudications, which could establish incompatible standards of conduct for defendants. Questions of law and fact common to the Class predominate over any questions which may affect only individual members. Among the common questions of law and fact are:

(a) whether defendants implemented the manipulative devices or engaged in the wrongful scheme alleged herein;

(b) whether defendants' statements omitted material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading;

(c) whether defendants misrepresented material facts;

(d) whether the 1934 Act or the 1933 Act was violated by defendants' acts as alleged herein;

(e) whether defendants knew or recklessly disregarded that the statements made by them were false and misleading;

(f) whether the prices of the Publicly Traded Securities were artificially inflated; and

(g) the extent of damage sustained by Class members and the appropriate measure of damages.

FIRST CLAIM FOR RELIEF

For Violation of §§10(b) and 20(a) of the 1934 Act and Rule 10b-5
(Against Buy, Causey, Fastow, Frevert, Hannon, Harrison, Hirko, Horton, Kean, Koenig, Lay, McMahon, Olson, Pai, Rice, Skilling, Sutton, Whalley, Arthur Andersen LLP, Andersen-Worldwide, Andersen-India, Andersen-Brazil, Andersen-United Kingdom, David Duncan, Cash, Goddard, Goolsby, Lowther, Vinson & Elkins, JP Morgan, CitiGroup, Barclays, and Deutsche Bank)

331. Plaintiffs incorporate ¶¶1-330 by reference.

332. This Claim is brought by plaintiffs against the defendants named below:

(a) Enron's top executives and directors:

Richard B. Buy	Mark E. Koenig
Richard A. Causey	Kenneth L. Lay
Andrew S. Fastow	Jeffrey McMahon
Mark A. Frevert	Cindy K. Olson
Kevin P. Hannon	Lou L. Pai
Ken L. Harrison	Kenneth D. Rice
Joseph M. Hirko	Jeffrey K. Skilling
Stanley C. Horton	Joseph W. Sutton
Steven J. Kean	Lawrence Greg Whalley

(b) Enron's accountants and affiliated entities and partners and officers therein:

Arthur Andersen LLP	David B. Duncan
Andersen-Worldwide	Debra A. Cash
Andersen-India	David Stephen Goddard, Jr.
Andersen-Brazil	Gary B. Goolsby
Andersen-United Kingdom	Michael M. Lowther

(c) The law firm that represented Enron and its related entities:

Vinson & Elkins

(d) The investment banks:

JP Morgan	Barclays
CitiGroup	Deutsche Bank

333. Each of the defendants named herein participated in defendants' wrongful scheme, the implementation of the manipulative devices discussed herein and/or in the preparation and dissemination of the false statements specified above, which they knew or recklessly disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

334. Defendants violated §§10(b) and/or 20(a) of the 1934 Act and Rule 10b-5 in that they:

(a) Employed devices, schemes, and artifices to defraud;

(b) Made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading; or

(c) Engaged in acts, practices and a course of business that operated as a fraud or deceit upon plaintiffs and others similarly situated in connection with their purchases of Enron securities during the Class Period.

335. Defendants' material misrepresentations and/or omissions were made knowingly and/or in reckless disregard of the truth and for the purpose and effect of concealing Enron's falsified financial results, operating condition and prospects from the investing public and supporting the artificially inflated price of its Publicly Traded Securities.

336. Plaintiffs and the other members of the Class as detailed herein have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices in connection with their purchase of Enron securities. Plaintiffs and the members of the Class would not have purchased Enron securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' wrongful scheme and/or false and misleading statements.

SECOND CLAIM FOR RELIEF

For Violations of §§11 and 15 of the 1933 Act (Against Lehman Brothers Holding, Inc., Lehman Brothers Inc., J.P. Morgan Chase & Co., JP Morgan Securities Inc., Arthur Andersen LLP, Lay, Belfer, Blake, Chan, John Duncan, Foy, Gramm, Harrison, Jaedicke, LeMaistre, Meyer, Skilling, Urquhart, Wakeham, Walker and Winokur)

337. Plaintiffs incorporate ¶¶1, 5-11, 13-31, 36-52, 70, 80, 90-95, 106-175, 179-180, 286-321, 325-330. For purposes of this claim, plaintiffs expressly exclude and disclaim any allegation that could be construed as alleging fraud or intentional or reckless misconduct, as this claim is based solely on claims of strict liability and/or negligence under the 1933 Act.

338. This Claim is brought pursuant to §§11 and 15 of the 1933 Act, 15 U.S.C. §§77k and 77o against Lehman Brothers Holding, Inc., Lehman Brothers Inc., J.P. Morgan Chase & Co., JP Morgan Securities Inc., Arthur Andersen LLP, Lay, Belfer, Blake, Chan, John Duncan, Foy, Gramm, Harrison, Jaedicke, LeMaistre, Meyer, Skilling, Urquhart, Wakeham, Walker and Winokur by the Washington Board, which bought the 6.4% and 6.95% Notes in July 1998.

339. The Registration Statements and Prospectus pursuant to the offering of Enron Corp. 6.40% Notes due 7/15/2006 ($250 million) and Enron Corp. 6.95% Notes due 7/15/2028 ($250

million) detailed in ¶¶70, 80 and 169 above, were false and misleading, as they omitted to state facts necessary to make the statements made not misleading and failed to adequately disclose material facts as described above.

340. Non-party Enron is the issuer and registrant of the securities sold via the Registration Statements.

Individual Defendants

341. The individual defendants named in ¶338 above (the "Individual Defendants") were responsible for the contents and dissemination of the Registration Statements as they signed the registration statements and participated in the preparation and dissemination of the Registration Statements and Prospectuses by preparing, reviewing and/or signing of the Registration Statements and Prospectuses and thereby causing their filing with the SEC.

342. Each of the Individual Defendants issued, caused to be issued and participated in the issuance of materially false and misleading written statements to the investing public which were contained in the Registration Statement, which misrepresented or failed to disclose, *inter alia*, the facts set forth above.

343. Each of the Individual Defendants prepared, reviewed and/or signed the Registration Statements and Prospectuses and/or were sellers of the securities sold in the offerings. None of the Individual Defendants named herein made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Registration Statements and Prospectuses were true and did not omit any material fact and were not misleading.

Accountants

344. Andersen consented to the inclusion or incorporation of its report on Enron's false financial statements in each of the Registration Statements and Prospectuses issued in connection with the offerings.

Investment Banks

345. The underwriters named in this Claim underwrote the Enron securities sold in the offerings as defined in §11(a)(5) of the 1933 Act as detailed in ¶339 above. As underwriters of the offerings, the underwriters were obligated to make reasonable and diligent investigations of the

statements contained in the Registration Statements and Prospectuses at the time they were filed with the SEC and/or became effective, to ensure that said statements were not misleading and that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. The underwriters did not make a reasonable and diligent investigation, nor did they possess reasonable grounds for the belief that the statements contained in the Registration Statements and Prospectuses at the time they became effective were true and that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. As such, the defendants detailed in the chart above are liable as detailed herein.

346. Plaintiffs herein and the members of the Offering Subclasses purchased the Enron securities detailed in ¶339 above, traceable to a false and misleading Registration Statement. As a direct and proximate result of defendants' acts and omissions in violation of the 1933 Act, plaintiffs and the members of the Offering Subclasses suffered substantial damage in connection with their purchases of the Enron securities sold in the offerings. By reasons of the conduct herein alleged, each defendant violated, and/or in violation of §15 of the 1933 Act controlled a person who violated, §11 of the 1933 Act.

347. At the times they purchased Enron securities traceable to the defective Registration Statements, plaintiffs and the members of the Offering Subclasses were without knowledge of the facts concerning the false or misleading statements or omissions alleged herein.

348. Deleted.

PRAYER FOR RELIEF

WHEREFORE, plaintiffs pray for relief and judgment, including preliminary and permanent injunctive relief, as follows:

A. Determining that this action is a proper class action, and certifying plaintiffs as class representatives under Rule 23 of the Federal Rules of Civil Procedure;

B. Awarding preliminary and permanent injunctive relief in favor of plaintiffs and the Class against defendants and their counsel, agents and all persons acting under, in concert with, or for them, including an accounting of and the imposition of a constructive trust and/or an asset freeze on defendants' insider trading proceeds;

C. Ordering an accounting of defendants' insider-trading proceeds;

D. Disgorgement of defendants' insider-trading proceeds;

E. Restitution of investors' monies of which they were defrauded;

F. Awarding compensatory damages in favor of plaintiffs and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

G. As to the §11 and/or §15 claims, awarding rescission or a recessionary measure of damages;

H. Awarding plaintiffs and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

I. Such other and further relief as the Court may deem just and proper.

JURY DEMAND

Plaintiffs hereby demand a trial by jury.

DATED: October 15, 2003

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William S. Lerach by [illegible] (w/ permission)

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing FIRST AMENDED COMPLAINT FOR VIOLATION OF THE SECURITIES LAWS has been served by sending a copy via electronic mail to serve@ESL3624.com on this 15th day of October, 2003.

I further certify that a copy of the foregoing document has been served via overnight mail on the following parties, who do not accept service by electronic mail on this 15th day of October, 2003.

Carolyn S. Schwartz
United States Trustee, Region 2
33 Whitehall Street, 21st Floor
New York, NY 10004

Deborah S. Granger